

## LEGISLATIVE COUNCIL BRIEF

Inland Revenue Ordinance  
(Chapter 112)

### **INLAND REVENUE (AMENDMENT) (TAXATION ON SPECIFIED FOREIGN-SOURCED INCOME) BILL 2022**

#### INTRODUCTION

At the meeting of the Executive Council on 25 October 2022, the Council ADVISED and the Chief Executive ORDERED that the Inland Revenue (Amendment) (Taxation on Specified Foreign-sourced Income) Bill 2022 (“the Bill”) at **Annex A** should be introduced into the Legislative Council (“LegCo”) to amend the Inland Revenue Ordinance (Cap. 112) (“IRO”).

#### JUSTIFICATIONS

2. We need to introduce a new foreign-sourced income exemption (“FSIE”) regime for passive income that is in line with the prevailing international tax standard of requiring adequate economic substance for preferential tax treatment, in order to address the concerns of the European Union (“EU”) over risks of double non-taxation arising from the general non-taxation of foreign-sourced passive income under Hong Kong’s territorial source principle of taxation.

3. Hong Kong has all along been actively participating in and supportive of international tax co-operation. The latest international tax standards require a taxpayer benefitting from a preferential tax treatment in a jurisdiction to have substantial economic presence in the jurisdiction, and to establish an explicit link between the relevant income and real activities in the jurisdiction. In this regard, it is accepted internationally that shell companies which do not have adequate economic substance in a jurisdiction shall not be granted tax benefits.

4. To address harmful tax competition, the EU has been requiring its Member States to refrain from introducing any harmful tax measures and to amend any laws or practices that are deemed to be harmful. With regard to non-EU jurisdictions, the EU has been evaluating their tax regimes against international tax standards and put in place a list of non-cooperative jurisdictions for tax purposes (“EU blacklist”) whereas jurisdictions that have committed to implementing reforms are included in a watchlist<sup>1</sup>.

5. Under our territorial source principle of taxation, foreign-sourced passive income is not chargeable to tax in Hong Kong. In October 2021, the EU placed Hong Kong in the watchlist in view of the possible risks of double non-taxation arising from the non-taxation of foreign-sourced passive income in the absence of any requirement for recipient companies to have a substantial economic presence in Hong Kong. The EU was mainly concerned about possible exploitation of the tax arrangement by shell companies for obtaining tax benefits. The EU invited Hong Kong to make a commitment to amend our tax laws by 31 December 2022 and that the amended regime would take place with effect from 1 January 2023. If Hong Kong does not address the EU’s concerns, the EU will include Hong Kong in the EU blacklist and Hong Kong-based enterprises may be subject to tax-related defensive measures, namely legislative defensive measures (e.g. denial of deduction of costs, higher withholding tax rate, etc.) and administrative defensive measures (e.g. reinforced monitoring of certain transactions, higher audit risks for taxpayers, etc.) imposed by the EU Member States.

6. To protect Hong Kong businesses against potential defensive measures that may arise from the EU’s blacklisting, it is necessary to introduce measures to bring our tax exemption for foreign-sourced passive income in line with the EU’s Guidance on Foreign Source Income Exemption Regimes<sup>2</sup> which requires adequate substance requirements and robust anti-abuse rules to be in place for the exemption. Under the premise of supporting international efforts in combating cross-border tax evasion and preventing double non-taxation, the Government

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<sup>1</sup> The EU blacklist and watchlist, which cover non-EU jurisdictions only, have been put in place since December 2017. They are regularly revised by the Economic and Financial Affairs Council (the ECOFIN Council), which is made up of the economic and finance ministers from all Member States.

<sup>2</sup> See the EU’s Guidance on Foreign Source Income Exemption Regimes at <https://data.consilium.europa.eu/doc/document/ST-13075-2019-INIT/en/pdf>.

announced in a public statement<sup>3</sup> in October 2021 that we would amend the IRO by the end of 2022 with a view to bringing the needed changes into force from 1 January 2023. There will be no grandfathering arrangement.

### **Guiding principles in formulating the new FSIE regime**

7. In formulating the new FSIE regime, we will uphold the following principles to protect Hong Kong's interests –

- (a) Hong Kong will continue to adhere to the territorial source principle of taxation;
- (b) Hong Kong's simple, certain and low-tax regime will be upheld with a view to maintaining the competitiveness of Hong Kong's business environment; and
- (c) the compliance burden of corporates will be minimised.

8. We also need to give due regard to the Guidance on Foreign Source Income Exemption Regimes promulgated by the EU in formulating our FSIE regime with regard to passive income with a view to ensuring that Hong Kong will not be blacklisted. As confirmed by the Code of Conduct Group (Business Taxation) ("COCG") of the EU<sup>4</sup> with us in June 2022, Hong Kong's FSIE regime should include the following parameters –

- (a) all types of passive income, namely interest, income from intellectual properties ("IP")<sup>5</sup> (hereinafter referred to as "IP income"), dividends and disposal gains in relation to shares or

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<sup>3</sup> See the press release issued on 5 October 2021 at <https://www.info.gov.hk/gia/general/202110/05/P2021100500291.htm>.

<sup>4</sup> The COCG is composed of high-level representatives of the member states of the EU and the European Commission. It was established in 1998 to assess tax measures that may fall within the scope of the Code of Conduct, which is an instrument used primarily to identify and assess possible harmful preferential tax measures in Member States. Besides, the COCG also conducts technical work, screenings and assessments of third country jurisdictions on the basis of the screening criteria and the agreed geographical scope to prepare revisions of the EU blacklist and watchlist.

<sup>5</sup> IP income refers to the income derived from the use of intellectual properties, such as royalties, licensing fees, etc.

equity interest (hereinafter referred to as “disposal gains”) should be covered;

- (b) adequate economic substance requirement should be imposed on taxpayers receiving tax exemption for non-IP income; the nexus approach should be adopted in granting tax exemption for IP income; and
- (c) robust anti-abuse rules should be put in place to tackle the specific risks of double non-taxation and lack of economic substance.

### **Consultation with the EU and stakeholders**

9. Between October 2021 and June 2022, Hong Kong engaged in several rounds of discussions with the EU and worked out the major legislative building blocks of the FSIE regime based on the parameters as communicated to us by the COCG of the EU. In June 2022, the COCG confirmed that the legislative building blocks proposed by Hong Kong were agreeable. Such legislative building blocks serve as the basis for consulting stakeholders and formulating the Bill.

10. Henceforth, we consulted stakeholders on the FSIE regime from June to September 2022 through the issuance of a consultation paper and the organisation of various engagement sessions. Extensive consultations with tax professionals; local and foreign chambers of commerce; trade and professional bodies; and representatives of the financial services sector were conducted. Opportunity was taken to explain the proposed new regime and solicit views and suggestions. Submissions from more than 20 organisations were received. Stakeholders generally recognised the need to comply with the international tax standards while attaching importance to the need to minimise compliance burden, provide tax certainty and maintain Hong Kong’s tax competitiveness. With the benefit of the feedback collected through the consultation exercise, we engaged in discussions with the EU again between September and October 2022 to ensure the suggestions that we took on board from the consultation aligned with the parameters that the COCG had agreed with Hong Kong in June 2022. In essence, we have largely taken on board the comments from the consultation exercise in finalising the legislative proposal, which will be discussed in the ensuing paragraphs.

## **Proposed new FSIE regime**

11. We propose to introduce a new FSIE regime, which adheres to the key guiding principles of Hong Kong’s taxation policy (see paragraph 7 above) and gives due regard to the parameters as communicated to Hong Kong and the key legislative building blocks as confirmed by the COCG of the EU in June 2022 (see paragraphs 8 and 9 above). The salient features of the new FSIE regime are as follows–

- (a) given the greater incentive of multinational enterprise (“MNE”) groups to adopt aggressive tax planning strategies and hence their higher base erosion and profit shifting (“BEPS”) risks, only constituent entities of MNE groups will be subject to the FSIE regime;
- (b) standalone local companies or purely local groups, which should cover most of the small and medium enterprises in Hong Kong, will fall outside the scope of the FSIE regime (see paragraphs 12 and 13 below). Their foreign-sourced passive income will remain not chargeable to tax;
- (c) for in-scope MNEs, the FSIE regime will allow foreign-sourced passive income to be exempt from tax provided that the economic substance requirement is met, i.e. the taxpayers concerned have a substantial economic presence in Hong Kong. Those taxpayers which benefit from the existing preferential tax regimes of Hong Kong will be carved out from the scope of the FSIE regime. Furthermore, any interest, dividend or disposal gain derived by a regulated financial entity from the carrying on of regulated business will be excluded from the scope of the new regime;
- (d) the economic substance requirement will align our FSIE regime with international tax standards and tackle the BEPS risks of shell companies and cross-border tax evasion in a targeted manner. The economic substance requirement will be applied in a way that takes into account both the totality of facts and the commercial reality of in-scope MNEs so as to maintain Hong Kong’s business-friendly environment (see paragraphs 17 to 19 below);

- (e) to minimise the compliance burden, enhance tax certainty and ensure tax transparency, the affected taxpayers will only need to fulfil simple compliance and reporting requirements, aided by elaborated guidance and dedicated facilitating measures to be put in place by the Inland Revenue Department (“IRD”) (see paragraphs 31 to 35 below). In particular, taxpayers may apply for advance rulings on whether the adequacy test of the economic substance requirement is met and avail themselves of the streamlined reporting requirements tied to the advance ruling; and
- (f) as it is not our policy objective to generate fiscal revenue through the FSIE regime, we will provide double taxation relief to those taxpayers who have paid taxes outside Hong Kong in respect of the foreign-sourced passive income. This not only covers the tax credit currently applicable to taxes paid in the jurisdictions which have entered into comprehensive avoidance of double taxation agreements (“CDTAs”) with Hong Kong (“CDTA jurisdictions”), but also a proposed new unilateral tax credit to be applicable to taxes paid in the jurisdictions which have not entered into a CDTA with Hong Kong (“non-CDTA jurisdictions”). Furthermore, a “look-through” approach will be adopted to determine the tax credits available to a taxpayer having regard to the tax payable on dividends and the underlying profits by the taxpayer and its investee companies.

All in all, the proposed measures will strengthen our new FSIE regime to tackle possible cross-border tax evasion while upholding Hong Kong’s territorial source principle of taxation as well as maintaining the simplicity, certainty and transparency of our tax regime. At the same time, we will ensure that the tax compliance burden is minimised (see details in paragraphs 31 to 35 below). Opportunity will also be taken to enhance our tax credit system (see details at paragraphs 24 to 28 below).

***(i) Covered income and covered taxpayers***

12. Under the proposed new FSIE regime, foreign-sourced income that is interest, IP income, dividend or disposal gain (hereinafter collectively referred to as “specified foreign-sourced income”) will be deemed to be sourced from Hong

Kong and chargeable to profits tax if –

- (a) the income is received in Hong Kong by a constituent entity of an MNE group (“MNE entity”) carrying on a trade, profession or business in Hong Kong (“covered taxpayer”) irrespective of its revenue or asset size; and
- (b) the recipient entity fails to meet the economic substance requirement as per paragraphs 17 to 19 below (if the income is non-IP income), or fails to comply with the nexus approach as per paragraphs 20 to 21 below (if the income is IP income).

Save for the above and unless otherwise provided under the IRO, other foreign-sourced income will continue to be exempt from tax in Hong Kong under the existing territorial source principle of taxation.

13. In defining the scope of taxpayers to be covered by the FSIE regime, we will make reference to the definitions of “MNE Group”<sup>6</sup> and other related terms as those in the context of the Global Anti-Base Erosion (“GloBE”) Rules<sup>7</sup> under BEPS 2.0<sup>8</sup> promulgated by the Organisation for Economic Co-operation and Development (“OECD”).

14. Interest, dividend and disposal gain generated by regulated financial

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<sup>6</sup> Under the GloBE Rules, an MNE Group means a Group that includes at least one entity or permanent establishment that is not in the jurisdiction of the ultimate parent entity of the group. The governing principle to determine a Group is to follow the accounting consolidation rules. If the applicable accounting principles do not require the financial results of an entity to be consolidated with its parent or associated entities on a line-by-line basis, that entity will not form part of a Group.

<sup>7</sup> The GloBE Model Rules are accessible through <https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.pdf>.

<sup>8</sup> BEPS 2.0 refers to the international tax reform package drawn up by the OECD to address tax challenges arising from the digitalisation of economy. Among over 130 jurisdictions, Hong Kong is committed to implementing BEPS 2.0 in accordance with international consensus.

entities<sup>9</sup> from the carrying on of their regulated businesses will not fall within the scope of the FSIE regime. This acknowledges the fact that such income is derived from the entities' substantial business activities (i.e. the regulated activities) carried out in Hong Kong.

15. Furthermore, we will provide carve-out for those taxpayers which benefit from the existing preferential tax regimes of Hong Kong from the scope of covered taxpayers, on account of the fact that the substantial activities requirements of the preferential tax regimes largely overlap with the economic substance requirement of the FSIE regime.

16. Having regard to the legislation of comparable jurisdictions, we propose defining "received in Hong Kong" with reference to the remittance or transmission of the passive income into Hong Kong as well as the settlement of debt incurred in respect of a trade, profession or business carried on in Hong Kong and the purchase of movable property brought into Hong Kong. This ensures that "received in Hong Kong" is not defined in such a way which is broader than necessary.

**(ii) *Economic substance requirement***

17. Under the new FSIE regime, specified foreign-sourced income that is not IP income and is received in Hong Kong by a covered taxpayer will be exempt from profits tax if the taxpayer conducts substantial economic activities with regard to the relevant passive income ("relevant activities") in Hong Kong. Details are set out below –

- (a) for a taxpayer that is not a pure equity-holding company<sup>10</sup>, the relevant activities will include making necessary strategic decision, and managing and bearing principal risks, in Hong Kong in respect of any assets it acquires, holds or disposes of;

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<sup>9</sup> The regulated financial entities refer to those authorised entities carrying on insurance business regulated by the Insurance Authority; authorised entities carrying on banking business or deposit-taking business regulated by the Hong Kong Monetary Authority; and those entities carrying on business in activities regulated by the Securities and Futures Commission.

<sup>10</sup> "Pure equity-holding company" means a company which, as its primary function, only holds equity interests in companies and only earns dividends, disposal gains and incomes incidental to the acquisition, holding or sale of such equity interests.



- (b) for a taxpayer that is a pure equity-holding company, a reduced substantial activities test can be applied such that the relevant activities will only include holding and managing its equity participations, and complying with the corporate law filing requirements in Hong Kong;
- (c) with regard to (a) and (b) above, outsourcing of the relevant activities will be permitted provided that the taxpayer is able to demonstrate adequate monitoring of the outsourced activities and that the outsourced activities are conducted in Hong Kong; and
- (d) to meet the economic substance requirement of the new regime, the taxpayer will need to meet an adequacy test in terms of employing an adequate number of qualified employees and incurring an adequate amount of operating expenditures in Hong Kong in relation to the relevant activities. In considering whether a taxpayer has met the adequacy test, the IRD will consider relevant factors, such as the nature of business, scale of operation, the number of employees and the amount of operating expenditures involved in the relevant activities, etc.

18. It is neither feasible nor appropriate to specify any minimum thresholds for the economic substance requirement because the mode of operation varies from industry to industry. In the case of the reduced substantial activities test applicable to pure equity-holding companies, the taxpayer concerned will only need to have adequate human resources and premises for holding and managing the equity participations in Hong Kong. Measures will be put in place to ease the compliance burden arising from the application of the economic substance requirement, with details set out in paragraphs 31 to 35 below.

19. We will continue to adhere to the territorial source principle of taxation and the determination on the source of profits will not be affected by the introduction of the economic substance requirement. The source of profits and the economic substance requirement will be considered in separate contexts, with the former continuing to be determined based on the prevailing requirements of the IRO and the broad guiding principle as established by judicial precedents and the latter to be based on the principles set out in paragraph 17 above. In other

words, covered taxpayers can still make offshore claims and be tax-exempt if they can satisfy the economic substance requirement.

*(iii) Nexus approach for IP income*

20. As far as foreign-sourced IP income is concerned, the nexus approach<sup>11</sup> will apply in determining the extent of such income to be exempted. All member jurisdictions of the Inclusive Framework on BEPS<sup>12</sup> with IP regimes have either adopted the nexus approach or abolished their non-compliant regimes. At present, the nexus approach is being applied by jurisdictions such as the Mainland of China, Israel, Portugal, Singapore, the United Kingdom, etc. in exempting IP income from tax.

21. Under the nexus approach, only income from a qualifying IP asset can qualify for preferential tax treatment based on a nexus ratio which is defined as the qualifying expenditures as a proportion of the overall expenditures that have been incurred by the taxpayer to develop the IP asset. The proportion of research and development (“R&D”) expenditures is a proxy for substantial economic activities. This seeks to ensure that there is a direct nexus between the income receiving benefits and the expenditures contributing to that income. Specifically, the nexus approach to be applied to the FSIE regime includes the following features –

- (a) qualifying IP assets only cover patents and other IP assets which are functionally equivalent to patents if those IP assets are both legally protected and subject to similar approval and registration processes (e.g. copyrighted software). Therefore, marketing-related IP assets (e.g. trademark and copyright) are excluded from preferential tax treatment;
- (b) qualifying expenditures only include R&D expenditures that are

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<sup>11</sup> The nexus approach was adopted by the OECD as a minimum standard under Action 5 of the BEPS package promulgated in 2015, and has been applied by the OECD Forum on Harmful Tax Practices to evaluate the harmfulness of preferential tax regimes for IP income (“IP regimes”) put in place by tax jurisdictions.

<sup>12</sup> The Inclusive Framework on BEPS allows interested countries and jurisdictions to work with the OECD and G20 members on developing standards on BEPS related issues and review and monitor the implementation of the BEPS Package. As of November 2021, the Inclusive Framework on BEPS has 141 member jurisdictions.

directly connected to the IP asset. Acquisition costs of the IP asset are not considered as qualifying expenditures, and therefore are not qualified for preferential tax treatment;

- (c) a taxpayer can apply a 30% uplift on the qualifying expenditures subject to the extent that the taxpayer has incurred non-qualifying expenditures<sup>13</sup>; and
- (d) the jurisdictional approach will be adopted for determining the scope of qualifying expenditures to ensure that the IP benefits are commensurate with the relevant domestic R&D activities<sup>14</sup>. Under this approach, qualifying expenditures cover the expenditures on the R&D activities:
  - (i) undertaken by the taxpayer inside or outside the jurisdiction providing the IP regime (“IP regime jurisdiction”);
  - (ii) outsourced to unrelated parties to take place inside or outside the IP regime jurisdiction; and
  - (iii) outsourced to resident related parties to take place within the IP regime jurisdiction.

***(iv) Participation exemption for dividends and disposal gains***

22. To allow a taxpayer to be tax-exempt in respect of the foreign-sourced dividends and disposal gains even if the taxpayer concerned is unable to comply with the economic substance requirement, we will introduce a participation exemption regime on the basis that –

- (a) the investor company (i.e. the taxpayer) is a Hong Kong resident

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<sup>13</sup> The purpose of the uplift is to ensure that the nexus approach does not over-penalise taxpayers for acquiring IP or outsourcing R&D activities to related parties (which are not otherwise considered as qualifying expenditures).

<sup>14</sup> The jurisdictional approach has also been adopted by Israel and Singapore for their IP regimes.

person<sup>15</sup> or a non-Hong Kong resident person that has a permanent establishment in Hong Kong;

- (b) the investor company holds at least 5% of the shares or equity interest in the investee company during the year of accrual of the relevant income; and
- (c) the investor company holds the shares or equity interest in the investee company for at least 12 months immediately prior to the accrual of the relevant income.

Participation exemption helps avoid possible double taxation (e.g. first on the investee company in the paying jurisdiction and later on the investor company in Hong Kong) and relieve compliance burden (i.e. claim for relief for double taxation by way of tax credit if applicable). The exemption conditions have been so designed to prevent non-Hong Kong resident entities having no nexus with Hong Kong from benefiting from the exemption.

23. Further, having regard to the EU's anti-abuse rules and the design of participation exemption regimes of other relevant jurisdictions, we consider it necessary to also subject our participation exemption regime to the following anti-abuse rules –

(a) Switch-over rule

If the income concerned or the profits of the investee company (in the case where the income concerned is dividend) is or are subject to tax in a foreign jurisdiction the headline tax rate of which is below 15%, the tax relief available to the investor company will switch over from participation exemption to foreign tax credit. In other words, the investor company will remain subject to Hong Kong profits tax in respect of the income concerned but with a deduction from tax of foreign tax paid attributable to the income concerned or the profits of the investee company. Such deduction will not exceed that part of Hong Kong profits tax, as computed before the deduction, which is attributable to the

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<sup>15</sup> A Hong Kong resident person means a person who is a resident for tax purposes in Hong Kong. In relation to a company, it means a company incorporated in Hong Kong or, if incorporated outside Hong Kong, normally managed or controlled in Hong Kong.

income concerned.

(b) Main purpose rule

In determining whether the participation exemption is available to the investor company, any arrangement or series of arrangements which, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the exemption, are not genuine having regard to all relevant facts and circumstances, will be ignored. An arrangement or a series of arrangements will be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.

(c) Anti-hybrid mismatch rule

Where the income concerned is a dividend, participation exemption will not apply to the extent that the dividend payment is deductible by the investee company when computing the amount of foreign tax payable on the underlying profits of the dividend.

(v) ***Double taxation relief***

24. It is possible that a covered taxpayer fails to meet the exemption conditions of the new FSIE regime but has nonetheless already paid tax (e.g. withholding tax) in respect of the specified foreign-sourced income in a non-CDTA jurisdiction. Under such circumstances, we propose to provide unilateral tax credit to Hong Kong resident persons in respect of the income concerned to avoid double taxation.

25. Insofar as unilateral tax credit is concerned, where the income is dividend, tax credits will be offered in respect of not only the foreign tax paid on the dividend, but also the foreign tax paid on the investee company's underlying profits out of which the dividend was paid. However, no tax credit will be available if the specified foreign-sourced income is exempt from profits tax under the FSIE regime<sup>16</sup> or if the tax paid in a non-CDTA jurisdiction relates to income

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<sup>16</sup> Specified foreign-sourced income received in Hong Kong by constituent entities of MNE

other than the specified foreign-sourced income.

26. For tax paid in CDTA jurisdictions, bilateral tax credit is already available pursuant to the relevant CDTA and the IRO. Nonetheless, to align the treatment of credit against foreign tax paid in a CDTA jurisdiction and in a non-CDTA jurisdiction, tax payable in respect of the underlying profits out of which dividends were paid in the CDTA jurisdiction will also be allowed as a credit against the relevant income which is chargeable to tax in Hong Kong under the FSIE regime.

27. We will also take the opportunity to enhance the provision of tax credits by introducing a “look-through” approach whereby the tax payable on dividends and the underlying profits by a chain of a maximum of five tiers of entities with 10% shareholding directly or indirectly held by the dividend receiving company will be allowed as credit.

28. As for the foreign tax paid by non-Hong Kong resident persons on the specified foreign-sourced income in CDTA jurisdictions or non-CDTA jurisdictions, it will be deductible as an expense in accordance with the existing provisions of the IRO.

29. Stakeholders generally welcome the enhanced mechanism to provide double taxation relief, which will help minimise their additional tax burden arising from the FSIE regime.

**(vi) *Anti-abuse rules***

30. If a covered taxpayer enters into an artificial arrangement with an intent to avoid the proposed deeming provisions (see paragraph 12 above) and in turn the profits tax charge on any in-scope foreign-sourced passive income, the general anti-avoidance rules as set out in sections 61 and/or 61A of the IRO will be applicable. With these provisions, the assessor or the assistant commissioner, as appropriate, is able to disregard the arrangement and assess the income accordingly.

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groups is exempt from tax if the conditions of the economic substance requirement (see paragraphs 17 to 19), the nexus approach requirement (see paragraphs 20 to 21) or participation exemption requirement (see paragraphs 22 to 23) are satisfied.

## **Facilitation measures for ease of compliance**

31. As foreshadowed in paragraph 11 above, we will put in place business-friendly compliance requirements and simplified reporting procedures. In this connection, a four-pronged approach will be adopted to provide ease of compliance.

32. To **minimise the compliance burden for taxpayers**, covered taxpayers will only be required to provide essential information to demonstrate compliance with the economic substance requirement in the tax return for the year of accrual of the relevant income. Specifically, if a specified foreign-sourced income is regarded to be sourced from Hong Kong under the FSIE regime and the taxpayer to which that income accrues wishes to claim a tax exemption upon receipt of the same in Hong Kong, the taxpayer needs to report the income in its profits tax return for the year of assessment in which the income accrues, as well as the essential information regarding its compliance with the economic substance requirement, participation exemption or nexus approach for the year of accrual. A taxpayer will only be required to report receipt of certain specified foreign-sourced income in Hong Kong to which no tax exemption is applicable in the year of accrual of the same income. If the taxpayer has not yet been required to file the profits tax return, it should notify the IRD of its receipt of the income. It should be noted that only some high-level information and declarations that are essential to IRD's determination of a taxpayer's eligibility for tax exemption or liability to tax under the FSIE regime will be required in the tax return. Further information may be requested upon review of the taxpayer's return.

33. To **enhance tax certainty**, taxpayers may also apply for an advance ruling on whether the adequacy test is satisfied, with the ruling remaining valid for up to five years. Where an advance ruling has been obtained, a covered taxpayer will be subject to streamlined reporting requirements by only disclosing the existence of the advance ruling and confirming its compliance with the conditions specified in the advance ruling (including for example the range of profits accrued). As a transitional measure to enhance tax certainty before the enactment of the Bill, taxpayers may apply for a "Commissioner's Opinion" ("Opinion") in respect of their compliance with the proposed economic substance requirement. The IRD will apply the enacted economic substance requirement in accordance with the Opinion provided that the arrangements and parameters stated in the Opinion are adhered to and the enacted economic substance requirement is substantially the same as that proposed in the Bill.

34. To **ensure tax transparency**, the IRD will publish elaborated administrative guidance aided with sector-specific illustrative examples to help taxpayers ascertain their tax liabilities. Specific guidance will also be published on the IRD's website in advance of the implementation of the FSIE regime with a view to facilitating early preparation of the taxpayers for the changes. Specifically, the administrative guidance will, among others, set out the factors that should be considered in analysing the compliance with the economic substance requirement. Factors to be considered include: (a) the average number of employees having regard to the nature of the relevant activities, e.g. whether it is a capital or labour-intensive industry; (b) whether the employees are employed on a full-time or part time basis; (c) whether the qualifications of the employees are related to the nature of the relevant activities; (d) the quantitative and qualitative aspects of the management and the administration of the taxpayer; and (e) whether office premises have been used for undertaking the relevant activities and whether the premises are adequate for such activities<sup>17</sup>. The guidance will also explain the application of the nexus approach as well as the rules governing the participation exemption regime and unilateral tax credit.

35. To **facilitate compliance by the affected MNEs**, a dedicated unit within the IRD will also provide technical support and respond to enquiries by them.

### *Tax competitiveness*

36. As one of the desired outcomes of the new FSIE regime, the competitiveness of Hong Kong's tax regime will be upheld while our good reputation as a responsible player in international taxation befitting the status of an international financial centre will be enshrined.

37. While the introduction of the new FSIE regime will require in-scope taxpayers to comply with the economic substance requirement for seeking tax exemption of their covered income, our overall tax regime with regard to foreign-sourced passive income remains competitive in the following aspects –

- (a) our new FSIE regime will only cover and apply economic

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<sup>17</sup> These factors are set out in the Guidance on the Interpretation of the Third Criterion of the Code of Conduct for Business Taxation issued by the COCG of the EU.



substance requirement or the nexus approach requirement, where appropriate, to foreign-sourced passive income;

- (b) the new regime covers MNEs only and standalone local companies or purely local groups will fall outside the scope of the regime
- (c) our regime exempts foreign-sourced dividends from tax in the absence of any subject-to-tax requirement outside Hong Kong provided that the economic substance requirement is met;
- (d) taxpayers meeting the participation exemption requirements will be allowed to claim tax exemption in respect of its foreign-sourced dividends and disposal gains even if they are unable to comply with the economic substance requirement. This provides an additional pathway for taxpayers to minimise their tax burden;
- (e) our regime allows foreign-sourced interest to be exempt from tax if the economic substance requirement is met; and
- (f) our regime allows taxpayers to claim tax credit under a business-friendly “look-through” approach which will further reduce the possibility of double taxation and hence tax burden for in-scope taxpayers.

38. Given the offshore claims for foreign-sourced IP income under the proposed FSIE regime will be substantially tied to R&D activities under the nexus approach<sup>18</sup>, we will explore devising a preferential tax regime for Hong Kong-sourced IP income to encourage more R&D activities in Hong Kong.

39. Likewise, since some enterprises may be prompted by the introduction of the FSIE regime to consider bringing transactions in respect of disposal of shares or equity interest onshore, we will look into appropriate measures to enhance tax certainty for such kind of transactions and the resulting gains of non-revenue nature (which are not taxable) with a view to facilitating corporate restructuring and minimising compliance cost.

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<sup>18</sup> Under the proposed new FSIE regime, foreign-sourced IP income will only be tax-exempt to the extent that the nexus approach is complied with. For details, please refer to paragraph 21 above.

## **Possible further development of FSIE guidance to be issued by the EU**

40. From time to time, the EU issues guidance covering different aspects of tax issues. It is possible that the EU may formulate and promulgate new guidance with regard to foreign-sourced passive income after the introduction of this Bill or in years to come. It is likely that the EU will adopt the latest guidance for further assessment of Hong Kong and other jurisdictions. If and when such new guidance is formally promulgated by the EU and consistently applied to all relevant jurisdictions for implementation at the same timing, Hong Kong will stand ready to explore further legislative amendments and consult stakeholders with a view to demonstrating that Hong Kong is a co-operative player in international taxation while safeguarding Hong Kong's tax competitiveness.

## **OTHER OPTIONS**

41. We must amend the IRO in order to give effect to the above proposal. There is no other viable option.

## **THE BILL**

42. The main provisions of the Bill are as follows –

- (a) **Clause 3** adds new Division 3A to Part 4 of the IRO –
  - (i) new sections 15H and 15I provide for the interpretation of terms, including “MNE entity”, “MNE group”, and “specified foreign-sourced income”;
  - (ii) new section 15J provides that a specified foreign-sourced income received in Hong Kong by an MNE entity carrying on a trade, profession or business in Hong Kong is to be regarded as a trading receipt arising in or derived from Hong Kong;

- (iii) new section 15K sets out the requirement to notify the Commissioner of Inland Revenue (“Commissioner”) the chargeability of specified foreign-sourced income;
  - (iv) new section 15L provides that new section 15J(1) does not operate if the economic substance requirement is satisfied (for interest, dividends and disposal gains);
  - (v) new section 15M provides that new section 15J(1) does not operate in relation to the excepted portion of qualifying IP income. Details on calculation of excepted portion are provided in new Schedule 17FC added by Clause 14;
  - (vi) new section 15N provides that new section 15J(1) does not operate if the participation exemption requirement is satisfied (for dividends and disposal gains);
  - (vii) new section 15O provides that new section 15N does not apply in certain circumstances;
  - (viii) new section 15P gives the meaning of “direct investee entity” and “indirect investee entity”;
  - (ix) new section 15Q provides for the setting-off of loss sustained outside Hong Kong;
  - (x) new section 15R provides for the deduction of outgoings and expenses incurred in the production of a specified foreign-sourced income;
  - (xi) new section 15S provides for the taking into account of allowances for specified foreign-sourced income;
  - (xii) new section 15T provides for the keeping of records for specified foreign-sourced income;
- (b) **Clauses 4, 5 and 7** make related amendments to sections 16, 50 and 51C of the IRO;

- (c) **Clause 6** adds new sections 50AAA, 50AAAB and 50AAAC to the IRO, and **Clause 17** adds new Schedule 54 to the IRO, to provide for the allowance of unilateral tax credit in respect of specified foreign-sourced income;
- (d) **Clauses 8, 9 and 10** amend sections 63C, 63H and 63M of the IRO to provide that tax credits are to be taken into account in computing provisional tax;
- (e) **Clauses 11 and 12** amend sections 80 and 82A of the IRO to provide for offence and additional tax for failure to comply with the requirements under new section 15K for failure to notify the Commissioner of the chargeability of specified foreign-sourced income; and
- (f) **Clauses 13 and 17** amend section 89 of the IRO and add new Schedule 55 to the IRO respectively to deal with transitional matters.

B

The existing provisions of the IRO being amended are at **Annex B**.

## LEGISLATIVE TIMETABLE

43. The legislative timetable is as follows –

Publication in the Gazette	28 October 2022
First Reading and commencement of Second Reading debate	2 November 2022
Resumption of Second Reading debate, committee stage and Third Reading	to be notified

## IMPLICATIONS OF THE PROPOSAL

44. The proposal is in conformity with the Basic Law, including the provisions concerning human rights. The proposal will not affect the binding effect of the existing provisions of the IRO and its subsidiary legislation. It has

no environmental, gender, family or productivity implications, and no sustainability implications other than those set out in the economic implications paragraphs in **Annex C**. The economic, financial and civil service implications of the proposal are set out in **Annex C**.

## **PUBLIC CONSULTATION**

45. We conducted a stakeholder consultation exercise from 17 June to 15 July 2022 on the proposed FSIE regime. A total of 27 written submissions were received. During the consultation period, we also organised over ten engagement sessions with key stakeholders. There is broad support for the overall objective to address the EU's concerns and minimise the compliance burden of the affected MNEs. Stakeholders have made various suggestions to refine the proposal and we have largely taken on board their comments when finalising the legislative proposal.

46. We briefed the LegCo Panel on Financial Affairs on the legislative proposal on 4 July 2022 and Panel members raised no objection to our proposal.

## **PUBLICITY**

47. We will issue a press release on 26 October 2022. A spokesperson will be available to answer enquiries.

## **BACKGROUND**

48. Under Hong Kong's territorial source principle of taxation, income not sourced from Hong Kong is generally not subject to tax in Hong Kong. Therefore, foreign-sourced passive income is not chargeable to tax in Hong Kong. On the other hand, the EU has been evaluating the tax regimes of non-EU jurisdictions against international tax standards to assess whether any elements therein are deemed to be harmful. The EU concluded in October 2021 that there were harmful elements in Hong Kong's tax system insofar as foreign-sourced passive income is concerned. The EU invited Hong Kong to make a commitment to amend our tax laws by 31 December 2022 and that the amended regime would take place with effect from 1 January 2023. In support of international tax co-operation, Hong Kong has committed to making the

necessary changes by the end of 2022 such that the treatment of the specified foreign-sourced income will be consistent with international standards from 1 January 2023.

## **ENQUIRIES**

49. In case of enquiries about this Brief, please contact Mr Stephen Lo, Principal Assistant Secretary for Financial Services and the Treasury (Treasury), at 2810 2317.

**Financial Services and the Treasury Bureau**

**October 2022**

## Inland Revenue (Amendment) (Taxation on Specified Foreign-sourced Income) Bill 2022

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## A BILL

## To

Amend the Inland Revenue Ordinance to provide that certain foreign-sourced income is to be regarded as arising in or derived from Hong Kong; to provide for relief against double taxation in respect of certain foreign-sourced income; and to provide for related and transitional matters.

Enacted by the Legislative Council.

### 1. Short title and commencement

(1) This Ordinance may be cited as the Inland Revenue (Amendment) (Taxation on Specified Foreign-sourced Income) Ordinance 2022.

(2) This Ordinance comes into operation on 1 January 2023.

### 2. Inland Revenue Ordinance amended

The Inland Revenue Ordinance (Cap. 112) is amended as set out in sections 3 to 17.

### 3. Part 4, Division 3A added

Part 4, after Division 3—

**Add**

## “Division 3A—Specified Foreign-sourced Income

### Subdivision 1—Preliminary

#### 15H. Interpretation of Division 3A of Part 4

(1) In this Division—

*consolidated financial statements* (綜合財務報表) means—

- (a) subject to paragraphs (b) and (c), the financial statements prepared by an entity under applicable accounting principles, in which the assets, liabilities, income, expenses and cash flows of the entity and the entities in which it has a controlling interest are presented as those of a single economic unit;
- (b) in relation to a stand-alone MNE entity—the financial statements of the entity prepared under applicable accounting principles; or
- (c) in relation to an ultimate parent entity that does not prepare any financial statements described in paragraph (a) or (b)—the financial statements that would have been prepared if the entity had been required to prepare financial statements under applicable accounting principles;

*controlling interest* (控制權益), in relation to an entity, means an equity interest in the entity such that—

- (a) the interest holder is required to consolidate the assets, liabilities, income, expenses and cash flows of the entity on a line-by-line basis under applicable accounting principles; or
- (b) the interest holder would have been required to consolidate the assets, liabilities, income, expenses

and cash flows of the entity on a line-by-line basis under applicable accounting principles if the interest holder had prepared consolidated financial statements;

**disposal gain** (處置收益) means any gain or profit derived from the sale of equity interests (other than partnership interests) in an entity;

**entity** (實體) means—

- (a) a legal person (other than a natural person); or
- (b) an arrangement that prepares separate financial accounts, such as a partnership and a trust;

**equity interest** (股權權益), in relation to an entity, means an interest that carries rights to the profits, capital or reserves of the entity and is accounted for as equity under applicable accounting principles;

**excluded entity** (豁除實體)—see section 15I;

**group** (集團) means—

- (a) a collection of entities that are related through ownership or control such that the assets, liabilities, income, expenses and cash flows of those entities—
  - (i) are required under applicable accounting principles to be included in the consolidated financial statements of the ultimate parent entity of the collection; or
  - (ii) are excluded from the consolidated financial statements of the ultimate parent entity solely on size or materiality grounds or on the grounds that the entities are held for sale; or
- (b) a stand-alone MNE entity;

**Hong Kong resident person** (香港居民人士) has the meaning given by section 50AAC(1);

**intellectual property** (知識產權) includes—

- (a) cinematograph film, film or tape used for radio or television broadcasting, sound recording, and advertising material connected with such film, tape or recording; and
- (b) patent, design, model, plan, trade mark, copyright material, layout-design (topography) of an integrated circuit, performer's right, plant variety right, secret process or formula, know-how, information concerning industrial, commercial or scientific experience, and other property or right of a similar nature;

**IP income** (知識產權收入) means income derived from intellectual property in respect of—

- (a) the exhibition or use of, or a right to exhibit or use, (whether in or outside Hong Kong) the property; or
- (b) the imparting of, or undertaking to impart, knowledge directly or indirectly connected with the use (whether in or outside Hong Kong) of the property;

**MNE entity** (跨國企業實體), subject to subsection (4), means a person that—

- (a) is, or acts for, an MNE group or an entity included in an MNE group; and
- (b) is not an excluded entity;

**MNE group** (跨國企業集團) means a group that includes at least one entity or permanent establishment that is not located or established in the jurisdiction of the ultimate parent entity of the group;

**partnership interest** (合夥權益) means an equity interest in a partnership that is not a legal person;

**permanent establishment** (常設機構)—see subsection (3);

**regulated financial entity** (受規管財務實體) means—

- (a) an insurer (as defined by section 2(1) of the Insurance Ordinance (Cap. 41)) authorized under that Ordinance, Lloyd's or an approved association of underwriters;
- (b) an authorized institution as defined by section 2(1) of the Banking Ordinance (Cap. 155); or
- (c) an entity licensed under Part V of the Securities and Futures Ordinance (Cap. 571) to carry on a business in any regulated activity as defined by Part 1 of Schedule 5 to that Ordinance;

**sale** (出售), in relation to equity interests, means a transfer of the interests (other than a transfer effected by extinguishing the interests) for valuable consideration;

**specified foreign-sourced income** (指明外地收入) means any interest, dividend, disposal gain or IP income arising in or derived from a territory outside Hong Kong, but does not include any interest, dividend or disposal gain derived by a regulated financial entity from the carrying on of a business as such a regulated financial entity;

**stand-alone MNE entity** (獨立跨國企業實體) means an entity that—

- (a) is located in one jurisdiction and has one or more permanent establishments in other jurisdictions; and
- (b) is not part of a collection of entities described in paragraph (a) of the definition of **group**;

**ultimate parent entity** (最終母實體) means—

- (a) an entity that—
    - (i) owns directly or indirectly a controlling interest in any other entity; and
    - (ii) is not owned, with a controlling interest, directly or indirectly by another entity; or
  - (b) a stand-alone MNE entity.
- (2) For the purposes of this Division—
- (a) if an entity is a tax resident in a jurisdiction based on its place of management, place of creation or similar criteria—the entity is to be regarded as located in that jurisdiction; or
  - (b) in any other case—the entity is to be regarded as located in the jurisdiction in which it was created.
- (3) For the purposes of this Division, an entity has a permanent establishment in a jurisdiction if—
- (a) where the jurisdiction is Hong Kong—the entity has a permanent establishment in Hong Kong under Schedule 17G; or
  - (b) where the jurisdiction is not Hong Kong—the entity is to be regarded as having a permanent establishment in the jurisdiction under the laws of the jurisdiction or under a bilateral or multilateral tax convention to which the jurisdiction is a party,

- and a reference to a permanent establishment in a jurisdiction is to be read accordingly.
- (4) For the purposes of this Division, if an MNE entity is a Hong Kong resident person, any permanent establishment of the entity outside Hong Kong is to be regarded as a separate MNE entity carrying on a trade, profession or business in the territory in which the permanent establishment is established.
- (5) For the purposes of this Division, without limiting the meaning of “received in Hong Kong”, a sum is to be regarded as received in Hong Kong if—
- (a) the sum is remitted to, or is transmitted or brought into, Hong Kong;
  - (b) the sum is used to satisfy any debt incurred in respect of a trade, profession or business carried on in Hong Kong; or
  - (c) the sum is used to buy movable property, and the property is brought into Hong Kong.
- (6) For the purposes of subsection (5)(c), the sum is to be regarded as being received at the time when the movable property is brought into Hong Kong.
- (7) Subsection (5) applies regardless of whether or not the source from which the sum is derived has ceased.

**15L. Meaning of *excluded entity***

- (1) Each of the following is an excluded entity—
- (a) a governmental entity;
  - (b) an international organization;
  - (c) a non-profit organization;
  - (d) a pension fund;
  - (e) an investment fund that is an ultimate parent entity;
  - (f) a real estate investment vehicle that is an ultimate parent entity;
  - (g) an insurance investment entity;
  - (h) an entity the assessable profits of which are chargeable to tax at the rate specified in a concession provision (as defined by section 19CA) other than section 14A(1);
  - (i) an entity that has any exempt sums (as defined by section 23B(12)) excluded under section 23B(4AA) from the amount of relevant sums (as defined by section 23B(12)) earned by or accrued to the entity.
- (2) In this section—
- governmental entity*** (政府實體) means an entity in relation to which all of the following criteria are met—
- (a) the entity is part of, or is wholly owned by—
    - (i) a government; or

- (ii) any political subdivision or local authority of a government;
- (b) the entity has the principal purpose of—
  - (i) fulfilling a government function; or
  - (ii) managing or investing the specified assets through the making and holding of investments, asset management and investment activities related to the specified assets;
- (c) the entity does not carry on a trade or business, other than an investment business described in paragraph (b)(ii);
- (d) the entity is accountable to the government on its overall performance;
- (e) the entity provides annual information reporting to the government;
- (f) the entity's assets vest in the government on dissolution;
- (g) to the extent the entity distributes net earnings, the earnings are distributed solely to the government with no portion of the earnings inuring to the benefit of any private person;

**insurance investment entity** (保險投資實體) means an entity in relation to which all of the following criteria are met—

- (a) the entity—
  - (i) is not an investment fund, but would be an investment fund if it were designed to pool assets (whether financial or non-financial) from a number of investors, at least some of

- which were not connected (within the meaning of subsection (3)); or
- (ii) is not a real estate investment vehicle, but would be a real estate investment vehicle if it held predominantly immovable property and were itself widely held;
- (b) the entity is established in relation to liabilities under an insurance or annuity contract;
- (c) the entity is wholly owned by an entity (*latter*) that is subject to regulation in the latter's location as an insurance company;

**international organization** (國際組織) means any intergovernmental organization (including a supranational organization), or its wholly owned agency or instrumentality, in relation to which all of the following criteria are met—

- (a) the organization, agency or instrumentality (*subject entity*) is comprised primarily of governments;
- (b) the subject entity has, with the jurisdiction in which it is established, in effect—
  - (i) a headquarters agreement;
  - (ii) arrangements that entitle its offices or establishments in the jurisdiction (including a subdivision, a local office or a regional office) to privileges and immunities; or
  - (iii) any other agreement substantially similar to a headquarters agreement;
- (c) the subject entity's income is prevented, by law or by its governing documents, from inuring to the benefit of any private person;

*investment fund* (投資基金) means any of the following entities—

- (a) an entity that is exempt from tax under section 20AC, 20ACA, 20AN or 20AO;
- (b) an entity that is a mutual fund, unit trust or similar investment scheme that—
  - (i) is authorized as a collective investment scheme under section 104 of the Securities and Futures Ordinance (Cap. 571); or
  - (ii) is, in the Commissioner's opinion, a bona fide widely held investment scheme that complies with the requirements of a supervisory authority within an acceptable regulatory regime;
- (c) an entity in relation to which all of the following criteria are met—
  - (i) the entity is designed to pool assets (whether financial or non-financial) from a number of investors, at least some of which are not connected (within the meaning of subsection (3));
  - (ii) subject to subsection (4), the entity invests in accordance with a defined investment policy;
  - (iii) the entity allows investors—
    - (A) to reduce transaction, research and analytical costs; or
    - (B) to spread risk collectively;
  - (iv) the entity is solely designed to generate—
    - (A) investment income or gains; or

- (B) protection against a particular or general event or outcome;
- (v) the investors of the entity have, based on the contributions they make, a right to return from its assets or income earned on those assets;
- (vi) the entity or its management is subject to a regulatory regime in the jurisdiction in which it is established or managed (including appropriate anti-money laundering and investor protection regulations);
- (vii) the entity is managed by investment fund management professionals on behalf of its investors;

*non-profit entity* (非牟利實體) means—

- (a) a professional organization;
- (b) a business league;
- (c) a chamber of commerce;
- (d) a labour organization;
- (e) an agricultural or horticultural organization;
- (f) a civic league; or
- (g) an organization operated exclusively for the promotion of social welfare;

*non-profit organization* (非牟利組織) means an entity in relation to which all of the following criteria are met—

- (a) the entity is established and operated in its jurisdiction of residence—
  - (i) exclusively for a non-profit purpose; or
  - (ii) as a non-profit entity;

- (b) substantially all of the entity's income from the following activities is exempt from income tax in its jurisdiction of residence—
  - (i) if the entity is established and operated in its jurisdiction of residence exclusively for a non-profit purpose—activities carried out for that non-profit purpose; or
  - (ii) if the entity is established and operated in its jurisdiction of residence as a non-profit entity—activities carried out as such a non-profit entity;
- (c) the entity has no shareholders or members who have a proprietary or beneficial interest in its income or assets;
- (d) the entity's income or assets may not be distributed to, or applied for the benefit of, a private person or non-charitable entity other than—
  - (i) pursuant to the conduct of its charitable activities;
  - (ii) as payment of reasonable compensation for services rendered or for the use of property or capital; or
  - (iii) as payment representing the fair market value of property that it has purchased;
- (e) on termination, liquidation or dissolution of the entity, all of the entity's assets are to be distributed, or revert, to—
  - (i) a non-profit organization; or

- (ii) the government of its jurisdiction of residence (including any political subdivision of the government and any governmental entity),

but does not include any entity carrying on a trade or business that is not directly related to the purposes for which it was established;

**non-profit purpose** (非牟利目的) means—

- (a) a religious, charitable, scientific, artistic, cultural, athletic or educational purpose; or
- (b) any other similar purpose;

**pension fund** (退休基金) means—

- (a) a pension fund entity; or
- (b) a pension services entity;

**pension fund entity** (退休基金實體) means an entity in relation to which both of the following criteria are met—

- (a) the entity is an entity established and operated in a jurisdiction exclusively or almost exclusively to administer, or provide to individuals, retirement benefits and ancillary or incidental benefits;
- (b) either—
  - (i) the entity is regulated as such an entity by that jurisdiction or one of its political subdivisions or local authorities; or
  - (ii) those benefits—
    - (A) are secured or otherwise protected by that jurisdiction's regulations; and
    - (B) are funded by a pool of assets held through a fiduciary arrangement or trust to secure the fulfilment of the

corresponding pension obligations against a case of insolvency of the group of which the entity is a member;

***pension services entity*** (退休金服務實體) means an entity (*former*) that is established and operated exclusively or almost exclusively—

- (a) to invest funds for the benefit of a pension fund entity; or
- (b) to carry out activities that are ancillary to the regulated activities carried out by a pension fund entity that is a member of the group of which the former is a member;

***real estate investment vehicle*** (房地產投資工具) means—

- (a) a collective investment scheme in relation to which all of the following criteria are met—
  - (i) the scheme does not engage in active trading of real estate;
  - (ii) the scheme invests predominantly in real estate for generating recurrent rental income;
  - (iii) the majority of income of the scheme derives from rentals of real estate;
  - (iv) the scheme distributes a significant portion of its income to holders in the form of regular dividends or other distributions (however described); or
- (b) an entity—
  - (i) that holds predominantly immovable property and is itself widely held; and

- (ii) the taxation in relation to which achieves a single level of taxation either in its hands or in the hands of its interest holders (with at most one year of deferral);

***specified assets*** (指明資產), in relation to a governmental entity, means—

- (a) the assets of the government, political subdivision or local authority—
    - (i) of which the entity is part; or
    - (ii) by which the entity is wholly owned; or
  - (b) the assets of the jurisdiction to which the government, political subdivision or local authority relates.
- (3) For the purposes of paragraph (a)(i) of the definition of ***insurance investment entity*** and paragraph (c)(i) of the definition of ***investment fund*** in subsection (2), 2 investors are connected if—
- (a) they are closely related (within the meaning of section 2 of Schedule 17G); or
  - (b) they are relatives (within the meaning of section 20AN(6)).
- (4) For the purposes of paragraph (c)(ii) of the definition of ***investment fund*** in subsection (2), the following factors are relevant in determining whether an investment policy is a defined one—
- (a) whether the investment policy is determined and fixed, at the latest by the time that investors' commitments to the fund concerned become binding on them;



- (b) whether the investment policy is set out in a document that becomes part of, or is referenced in, the rules, or instruments of incorporation, of the fund;
- (c) whether the fund or legal person managing the fund has an obligation (however arising) to investors, which is legally enforceable by them, to follow the investment policy, including all changes to it;
- (d) whether the investment policy specifies any investment guidelines, such as requiring the fund—
  - (i) to invest in certain categories of assets or conform to certain restrictions on asset allocation;
  - (ii) to pursue certain strategies;
  - (iii) to invest in particular geographical regions;
  - (iv) to conform to restrictions on leverage;
  - (v) to conform to minimum holding periods; or
  - (vi) to conform to other restrictions designed to provide risk diversification.

**Subdivision 2—Treatment of Specified Foreign-sourced  
Income for Charging Profits Tax**

**15J. Specified foreign-sourced income regarded as arising in or  
derived from Hong Kong**

- (1) For charging profits tax, specified foreign-sourced income to which this subsection applies—
  - (a) is to be regarded as a receipt arising in or derived from Hong Kong for the basis period of the year of

assessment during which the income is received in Hong Kong; and

- (b) is to be regarded as not arising from the sale of capital assets even if it so arises.
- (2) Subsection (1) is subject to Subdivision 3.
- (3) Subsection (1) applies to specified foreign-sourced income that—
  - (a) is received in Hong Kong by an MNE entity carrying on a trade, profession or business in Hong Kong; and
  - (b) is not otherwise chargeable to profits tax under this Part.
- (4) Despite subsection (3), if a sum is both—
  - (a) a sum to which section 15 or 15F applies; and
  - (b) but for this subsection, income to which subsection (1) would have applied,subsection (1) does not apply to the sum.
- (5) To avoid doubt, if—
  - (a) any specified foreign-sourced income is received in Hong Kong by an MNE entity after the entity ceases to carry on a trade, profession or business in Hong Kong; and
  - (b) had the income been received before the cessation, it would have been chargeable to profits tax because of subsection (1),section 15D applies in relation to the income.

**15K. Notification**

If an MNE entity is chargeable to profits tax in respect of any specified foreign-sourced income under this Part because of section 15J(1), the entity must notify the Commissioner in writing that the entity is so chargeable within 4 months after the end of the basis period of the year of assessment during which the income is received in Hong Kong, unless the entity has already been required to furnish a return under section 51(1).

**Subdivision 3—Exceptions from Section 15J(1)**

**15L. Exception 1: interest, dividend or disposal gain subject to economic substance requirement being met**

- (1) Section 15J(1) does not operate in relation to specified foreign-sourced income received in Hong Kong by an MNE entity if—
  - (a) the income is interest, a dividend or a disposal gain; and
  - (b) the economic substance requirement specified in subsection (2) is met.
- (2) The economic substance requirement is that during the basis period of the year of assessment in which the income accrues to the MNE entity—
  - (a) if the entity is a pure equity-holding entity—
    - (i) the entity complies with every applicable registration and filing requirement under the following Ordinances—
      - (A) the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32);

- (B) the Limited Partnerships Ordinance (Cap. 37);
  - (C) the Business Registration Ordinance (Cap. 310);
  - (D) the Companies Ordinance (Cap. 622);
  - (ii) specified economic activities are—
    - (A) carried out in Hong Kong by the entity; or
    - (B) arranged by the entity to be carried out in Hong Kong; and
  - (iii) in the Commissioner's opinion, the entity has adequate human resources and premises for carrying out the specified economic activities; or
- (b) if the entity is not a pure equity-holding entity—
- (i) specified economic activities are—
    - (A) carried out in Hong Kong by the entity; or
    - (B) arranged by the entity to be carried out in Hong Kong;
  - (ii) the number of employees in Hong Kong who—
    - (A) carry out the specified economic activities; and
    - (B) have the qualifications necessary for doing so,is adequate in the Commissioner's opinion; and

- (iii) the total amount of operating expenditure incurred in Hong Kong for carrying out the specified economic activities is adequate in the Commissioner's opinion.

(3) In this section—

*pure equity-holding entity* (純股權持有實體) means an entity that—

- (a) only holds equity interests in other entities; and
- (b) only earns—
  - (i) dividends;
  - (ii) disposal gains; and
  - (iii) income incidental to the acquisition, holding or sale of such equity interests;

*specified economic activities* (指明經濟活動) means—

- (a) in relation to an MNE entity that is a pure equity-holding entity—holding and managing its equity participations in other entities; or
- (b) in relation to an MNE entity that is not a pure equity-holding entity—
  - (i) making necessary strategic decisions in respect of any assets the entity acquires, holds or disposes of; and
  - (ii) managing and bearing principal risks in respect of such assets.

**15M. Exception 2: excepted portion of qualifying IP income ascertained in accordance with nexus requirement**

- (1) If any specified foreign-sourced income received in Hong Kong by an MNE entity is qualifying IP income, section

15J(1) does not operate in relation to the excepted portion of the income ascertained under Part 2 of Schedule 17FC.

- (2) Part 3 of Schedule 17FC applies in relation to the qualifying IP income.
- (3) The Secretary for Financial Services and the Treasury may, by notice published in the Gazette, amend Schedule 17FC.

(4) In this section—

*excepted portion* (例外部分)—see section 3 of Schedule 17FC;

*qualifying IP income* (合資格知識產權收入) has the meaning given by section 1(2) of Schedule 17FC.

**15N. Exception 3: dividend or disposal gain subject to participation requirement being met**

- (1) Subject to section 15O, section 15J(1) does not operate in relation to specified foreign-sourced income received in Hong Kong by an MNE entity if—
  - (a) the entity is—
    - (i) a Hong Kong resident person; or
    - (ii) a non-Hong Kong resident person who has a permanent establishment in Hong Kong;
  - (b) the income is—
    - (i) if the entity is a Hong Kong resident person—a dividend or disposal gain; or
    - (ii) if the entity is a non-Hong Kong resident person—a dividend or disposal gain attributable to the entity's permanent

- establishment in Hong Kong under section 50AAK; and
- (c) the participation requirement specified in subsection (2) is met.
- (2) The participation requirement is that the MNE entity has continuously held not less than 5% of equity interests in the investee entity for a period of not less than 12 months immediately before the specified foreign-sourced income accrues to the MNE entity.
- (3) In this section—
- investee entity* (獲投資實體) means—
- (a) in relation to an MNE entity that receives a dividend—the entity that distributes the dividend; or
- (b) in relation to an MNE entity that receives a disposal gain—the entity the equity interests in which are sold;
- non-Hong Kong resident person* (非香港居民人士) has the meaning given by section 50AAC(1).

**150. When does section 15N not apply**

- (1) This section applies to specified foreign-sourced income in relation to which section 15J(1), but for this section, would not have operated because of section 15N.
- (2) Section 15N only applies if the Commissioner is satisfied that—
- (a) where the specified foreign-sourced income is a dividend (whether or not the underlying profits of the income consist of any dividend)—
- (i) the income is subject to a qualifying similar tax in a territory outside Hong Kong; or

- (ii) the underlying profits of the income are subject to a qualifying similar tax in a territory outside Hong Kong, and the amount of the profits is equal to or larger than that of the income;
- (b) where the specified foreign-sourced income (*subject income*) is a dividend, and the underlying profits of the subject income consist wholly or partly of dividends—
- (i) one or more items of the related downstream income of the profits are subject to a qualifying similar tax in a territory outside Hong Kong; and
- (ii) the aggregate amount of all such items of income is equal to or larger than the amount of the subject income; or
- (c) where the specified foreign-sourced income is a disposal gain—the income is subject to a qualifying similar tax in a territory outside Hong Kong.
- (3) Where—
- (a) the specified foreign-sourced income is a dividend; and
- (b) tax is charged on the underlying profits of the income in a territory outside Hong Kong,
- section 15N does not apply if, and to the extent that, the income is allowable for deduction when computing the amount of the tax.
- (4) Section 15N also does not apply if—
- (a) the MNE entity receiving the specified foreign-sourced income entered into an arrangement in respect of the income; and

- (b) the Commissioner is satisfied that the main purpose, or one of the main purposes, of the entity in entering into the arrangement was to obtain a tax benefit, whether for the entity or another person, under that section for the income.
- (5) To avoid doubt and without limiting sections 50, 50AAA and 50AAAB (*those sections*), if section 15N does not apply because of this section, any similar tax payable in the source territory—
- (a) in respect of the specified foreign-sourced income; and
- (b) if the income is a dividend—in respect of the underlying profits and in respect of any related downstream income of the profits,
- may, in accordance with those sections, be allowed as a credit against any tax payable in respect of the specified foreign-sourced income in Hong Kong.
- (6) For the purposes of subsection (2), a sum is subject to a qualifying similar tax in a territory outside Hong Kong if—
- (a) the sum is subject to a similar tax in that territory; and
- (b) the applicable rate, or (if there is more than one applicable rate) the highest applicable rate, of that tax is equal to or higher than the reference rate.
- (7) For the purposes of subsection (6)(b), the reference rate is 15%.
- (8) The Secretary for Financial Services and the Treasury may, by notice published in the Gazette, amend the reference rate in subsection (7).
- (9) In this section—
- applicable rate* (適用稅率), in relation to a similar tax to which a sum is subject, means—

- (a) if the tax is chargeable at the time the sum accrues—the rate of the tax applicable to the sum at that time; or
- (b) if the tax is chargeable for the taxable period during which the sum accrues—the rate of the tax applicable to the sum for that taxable period;

*direct investee entity* (直接獲投資實體)—see section 15P(1);

*indirect investee entity* (間接獲投資實體)—see section 15P(2);

*investee entity* (獲投資實體), in relation to an entity, means a direct investee entity, or an indirect investee entity, of the entity;

*qualifying similar tax* (合資格類似稅項)—see subsection (6);

*related downstream income* (有關下游收入), in relation to a subject investee entity's underlying profits that consist wholly or partly of dividends (*underlying dividends*), means—

- (a) the underlying dividends;
- (b) if the underlying dividends—
- (i) are paid out of the profits of a direct investee entity of the subject investee entity; or
- (ii) are derived from the profits of an indirect investee entity of the subject investee entity through another investee entity of the subject investee entity,

those profits (*downstream profits*); or

- (c) if the downstream profits consist wholly or partly of dividends—those dividends;

*similar tax* (類似稅項) has the meaning given by section 16(2)(b);

*source territory* (來源地區) means—

- (a) in relation to specified foreign-sourced income—the territory in which the income accrues;
- (b) in relation to underlying profits—the territory in which the profits accrue; or
- (c) in relation to related downstream income—the territory in which the income accrues;

*subject investee entity* (標的獲投資實體), in relation to an MNE entity that receives a dividend, means the entity that distributes the dividend;

*tax benefit* (稅務利益) means an avoidance, postponement or reduction of a liability to pay tax;

*underlying profits* (基礎利潤), in relation to a dividend distributed by a subject investee entity, means the profits of the entity out of which the dividend is paid.

**15P. Supplementary provision to section 15O: meaning of *direct investee entity* and *indirect investee entity***

- (1) An entity (*entity B*) is a direct investee entity of another entity (*entity A*) if—
  - (a) entity A has any direct beneficial interest in, or in relation to, entity B; or
  - (b) entity A is directly entitled to exercise, or control the exercise of, any voting rights in, or in relation to, entity B.
- (2) An entity (*entity C*) is an indirect investee entity of entity A if—

- (a) entity A has any indirect beneficial interest in, or in relation to, entity C through another entity or a series of 2 or 3 entities; or
  - (b) entity A is indirectly entitled to exercise, or control the exercise of, any voting rights in, or in relation to, entity C through another entity or a series of 2 or 3 entities.
- (3) To avoid doubt, an entity (*entity D*) is not an indirect investee entity of entity A if none of the conditions in subsection (2) is satisfied in relation to them, even when—
- (a) entity A has any indirect beneficial interest in, or in relation to, entity D through a series of 4 or more entities; or
  - (b) entity A is indirectly entitled to exercise, or control the exercise of, any voting rights in, or in relation to, entity D through a series of 4 or more entities.
- (4) In applying subsection (1)(b), (2)(b) or (3)(b), the voting rights attributed to entity A include all the voting rights of persons other than entity A so far as they are required, or may be required, to be exercised in one or more of the following ways—
- (a) on behalf of entity A;
  - (b) under the direction of entity A;
  - (c) for the benefit of entity A.
- (5) For the purposes of this section, if—
- (a) a reference is made to the exercise of the voting rights in an entity; and
  - (b) the entity is a corporation,
- the reference is to be read as a reference to the exercise of the voting rights at general meetings of the entity.

#### Subdivision 4—Supplementary Provisions

##### 15Q. Setting off loss sustained from sale of equity interests outside Hong Kong

- (1) This section applies if—
  - (a) an MNE entity sustains a loss from a sale in a territory outside Hong Kong of its equity interests (other than partnership interests) in another entity;
  - (b) the proceeds of the sale are received in Hong Kong by the MNE entity during the basis period of a year of assessment; and
  - (c) had a gain been derived from the sale and received in Hong Kong by the MNE entity, the gain would have been chargeable to profits tax because of section 15J(1).
- (2) Subject to subsection (3)—
  - (a) the loss may be set off against the MNE entity's assessable profits for that year of assessment; and
  - (b) any amount of the loss not so set off may be carried forward and set off, in accordance with section 19C, against the MNE entity's assessable profits for subsequent years of assessment.
- (3) The loss may only be set off to the extent that the assessable profits concerned are derived from specified foreign-sourced income that is chargeable to profits tax because of section 15J(1).

##### 15R. Outgoing or expense incurred in production of specified foreign-sourced income may be deducted

Without limiting Division 4, if—

- (a) an outgoing or expense (however called) is incurred in the production of specified foreign-sourced income; and
- (b) the income is chargeable to profits tax for a year of assessment (*that year of assessment*) because of section 15J(1),

that outgoing or expense may be deducted in accordance with Division 4, to the extent that it has not been deducted for any year of assessment, for that year of assessment as if it were incurred during the basis period of that year of assessment.

##### 15S. Balancing charge or allowance relating to production of specified foreign-sourced income may be taken into account

Without limiting sections 18F and 19E and Part 6, if—

- (a) any balancing charge directed to be made on, or any allowance made to, an MNE entity under Part 6 for a year of assessment (or any part of such a charge or allowance) is not taken into account under section 18F or 19E when calculating the amount of the entity's assessable profits or loss for that year of assessment because—
  - (i) that charge or allowance, or that part of the charge or allowance, relates to the production of specified foreign-sourced income; and
  - (ii) the income—
    - (A) is not received in Hong Kong during the basis period of that year of assessment; and
    - (B) is not chargeable to profits tax for that year of assessment; and

(b) the income—

- (i) is received in Hong Kong during the basis period of a subsequent year of assessment; and
- (ii) is chargeable to profits tax for that subsequent year of assessment because of section 15J(1),

that charge or allowance, or that part of the charge or allowance, is to be taken into account under section 18F or 19E (as the case requires) when calculating the amount of the entity's assessable profits or loss for that subsequent year of assessment as if that charge or allowance, or that part of the charge or allowance, were directed to be made on, or made to, the entity under Part 6 for that subsequent year of assessment.

**15T. Records to be kept**

- (1) Section 51C applies, with the modifications specified in subsection (2), to an MNE entity that receives in Hong Kong specified foreign-sourced income to which section 15J(1) applies.
- (2) The MNE entity must retain records of transactions, acts or operations relating to the specified foreign-sourced income under section 51C at least until the later of the following—
  - (a) the expiry of 7 years after the completion of those transactions, acts or operations; or
  - (b) the expiry of 7 years after the income is received, or to be regarded as received, in Hong Kong.
- (3) Section 80 applies to a failure to comply with section 51C as modified by subsection (2) in the same way section 80 applies to a failure to comply with section 51C.”.

**4. Section 16 amended (ascertainment of chargeable profits)**

Section 16(2J)—

**Repeal**

everything after “in a”

**Substitute**

“territory outside Hong Kong by a person in respect of the profits referred to in that subsection if, under section 50, the tax is to be allowed as a credit against tax payable in Hong Kong by the person in respect of the profits.”.

**5. Section 50 amended (tax credits)**

- (1) Section 50, heading, after “credits”—

**Add**

“under double taxation arrangements”.

- (2) Section 50(7)—

**Repeal**

“Where—”

**Substitute**

“Subject to subsections (7A) and (7B), where—”.

- (3) After section 50(7)—

**Add**

“(7A) Subsection (7B) applies if the arrangements provide that where—

- (a) the income concerned is a dividend received by a Hong Kong resident person (*subject person*) from a company that is a DTA territory resident person (*investee company*); and



(b) the dividend is paid out of the investee company's profits,

the tax payable in respect of the profits in the DTA territory concerned (*underlying tax*) is, subject to the satisfaction of any conditions or provisions stated in the arrangements, to be taken into account in determining the amount of credit and (if any) deduction to be allowed to the subject person in respect of the dividend.

(7B) In determining the amount of credit and (if any) deduction to be allowed to the subject person in respect of the dividend, the underlying tax is to be taken into account in accordance with the arrangements.”.

6. Sections 50AAA, 50AAAB and 50AAAC added

After section 50—

Add

“50AAA. Unilateral tax credits—no double taxation arrangements or specified DT arrangements made

- (1) This section applies if—
- (a) no double taxation arrangements have been made with the government of a territory outside Hong Kong (*subject territory*); or
  - (b) double taxation arrangements have been made with the government of the subject territory, but the arrangements do not incorporate any of the following articles and rules—
    - (i) the exemption article;
    - (ii) the credit article;

(iii) any rules in the same or equivalent terms as those articles.

(2) Section 50 applies in relation to any similar tax payable in the subject territory in respect of income specified in Part 2 of Schedule 54 (*specified income*) if the condition specified in that Part for the income is satisfied.

(3) For the purposes of subsection (2), section 50 is to apply, with the modifications specified in Part 2 of Schedule 54 (if any) for applying that section in relation to the similar tax, as if—

(a) where no double taxation arrangements have been made with the government of the subject territory—

(i) double taxation arrangements containing the provisions specified in Part 2 of Schedule 54 for the similar tax (*specified provisions*) were made with the government of the subject territory; and

(ii) the subject territory were a DTA territory; and

(b) where double taxation arrangements have been made with the government of the subject territory, but the arrangements do not incorporate any of the articles and rules mentioned in subsection (1)(b)—further double taxation arrangements containing the specified provisions were made with the government of the subject territory.

(4) The transitional arrangement specified in Part 2 of Schedule 54 for the specification of the specified income has effect.

- (5) Section 50AAAB applies in relation to any profits tax payable in Hong Kong in respect of any specified income that is a dividend as if—
- (a) specified DT arrangements (as defined by subsection (10) of that section) containing the specified provisions were made with the government of the subject territory; and
  - (b) where the subject territory is not already a DTA territory—the territory were a DTA territory.
- (6) The Secretary for Financial Services and the Treasury may, by notice published in the Gazette, amend—
- (a) the definitions of the following expressions in subsection (7)—
    - (i) *Convention* (《協定》);
    - (ii) *credit article* (抵免條文);
    - (iii) *exemption article* (豁免條文); and
  - (b) Schedule 54.
- (7) In this section—
- Convention* (《協定》) means the Model Tax Convention on Income and on Capital as approved by the Organisation for Economic Co-operation and Development on 21 November 2017;
- credit article* (抵免條文) means the rules contained in Article 23B of the Convention;
- exemption article* (豁免條文) means the rules contained in Article 23A of the Convention;
- similar tax* (類似稅項), in relation to specified income, means a tax that is of substantially the same nature as the tax specified in Part 2 of Schedule 54 for the income.

**50AAAB. Unilateral tax credits—no relief for underlying profits etc. under specified DT arrangements made**

- (1) This section applies if—
- (a) a Hong Kong resident person (*subject person*) receives a dividend (*subject dividend*) from a company that is a DTA territory resident person (*subject company*);
  - (b) the subject dividend is paid out of the subject company's profits (*underlying profits*);
  - (c) when the subject dividend is distributed, the subject person has an adequate interest in the subject company; and
  - (d) specified DT arrangements are made with the government of the DTA territory concerned.
- (2) Subsection (3) applies if, under the specified DT arrangements, no provision is made for a similar tax payable in the DTA territory in respect of the underlying profits (*first-tier UP tax*) to be allowed as a credit against profits tax payable in Hong Kong.
- (3) Subject to subsection (9), the first-tier UP tax is to be allowed under section 50(7B) as a credit against profits tax payable in Hong Kong by the subject person in respect of the subject dividend as if—
- (a) the specified DT arrangements contained a provision to that effect; and
  - (b) in section 50(7B)—
    - (i) the reference to “dividend” were a reference to the subject dividend;
    - (ii) the reference to “underlying tax” were a reference to the first-tier UP tax; and

- (iii) the reference to “arrangements” were a reference to the specified DT arrangements.
- (4) Subsection (5) applies if—
  - (a) the underlying profits consist wholly or partly of dividends (*underlying dividends*);
  - (b) a similar tax (*first-tier D tax*) is payable in a territory outside Hong Kong in respect of the underlying dividends;
  - (c) when the underlying dividends are distributed, the subject person has an adequate interest in the subject company; and
  - (d) under the specified DT arrangements, no provision is made for the first-tier D tax to be allowed as a credit against profits tax payable in Hong Kong.
- (5) Subject to subsection (9), the first-tier D tax is to be allowed under section 50(7B) as a credit against profits tax payable in Hong Kong by the subject person in respect of the subject dividend as if—
  - (a) the specified DT arrangements contained a provision to that effect; and
  - (b) in section 50(7B)—
    - (i) the reference to “dividend” were a reference to the subject dividend;
    - (ii) the reference to “underlying tax” were a reference to the first-tier D tax; and
    - (iii) the reference to “arrangements” were a reference to the specified DT arrangements.
- (6) Subsections (7) and (8) apply if—
  - (a) the underlying dividends—

- (i) are paid out of the profits of a direct investee entity of the subject company; or
- (ii) are derived from the profits of an indirect investee entity of the subject company through another investee entity of the subject company; and
- (b) the subject person has an adequate interest in—
  - (i) in the case of paragraph (a)(i)—that direct investee entity; or
  - (ii) in the case of paragraph (a)(ii)—that indirect investee entity.
- (7) If—
  - (a) a similar tax (*downstream UP tax*) is payable in a territory outside Hong Kong in respect of the profits mentioned in subsection (6)(a)(i) or (ii) (as the case requires); and
  - (b) under the specified DT arrangements, no provision is made for the downstream UP tax to be allowed as a credit against profits tax payable in Hong Kong, subsection (3) applies to the downstream UP tax as if the references to the first-tier UP tax in subsection (3) were references to the downstream UP tax.
- (8) If—
  - (a) the profits mentioned in subsection (6)(a)(i) or (ii) (as the case requires) consist wholly or partly of dividends (*downstream dividends*);
  - (b) a similar tax (*downstream D tax*) is payable in a territory outside Hong Kong in respect of the downstream dividends; and

- (c) under the specified DT arrangements, no provision is made for the downstream D tax to be allowed as a credit against profits tax payable in Hong Kong, subsection (5) applies to the downstream D tax as if the references to the first-tier D tax in subsection (5) were references to the downstream D tax.
- (9) Any credit allowed under section 50 because of subsection (3) or (5) must represent the extent of—
- (a) the direct or indirect beneficial interest the subject person has in, or in relation to, the subject company or investee entity concerned (as the case requires); or
  - (b) the voting rights the subject person is (whether directly or indirectly) entitled to exercise, or control the exercise of, in or in relation to the subject company or investee entity concerned (as the case requires),
- as ascertained when determining whether the subject person has an adequate interest in that company or investee entity.
- (10) In this section—
- adequate interest* (足夠權益)—see section 50AAAC;
- direct investee entity* (直接獲投資實體)—see section 15P(1);
- entity* (實體) has the meaning given by section 15H(1);
- indirect investee entity* (間接獲投資實體)—see section 15P(2);
- investee entity* (獲投資實體), in relation to an entity, means a direct investee entity, or an indirect investee entity, of the entity;

- similar tax* (類似稅項) has the meaning given by section 16(2)(b);
- specified DT arrangements* (指明雙重課稅安排) means double taxation arrangements that incorporate—
- (a) the credit article or exemption article as defined by section 50AAA(7); or
  - (b) any rules in the same or equivalent terms as those articles.

**50AAAC. Supplementary provision to section 50AAAB: determining whether interest is adequate**

- (1) A person (*person A*) has an adequate interest in another person (*person B*) if—
  - (a) person A has at least 10% of direct or indirect beneficial interest in, or in relation to, person B; or
  - (b) person A is, directly or indirectly, entitled to exercise, or control the exercise of, at least 10% of the voting rights in, or in relation to, person B.
- (2) In applying subsection (1), if person A has a direct beneficial interest in person B, the extent of the beneficial interest of person A in person B is—
  - (a) if person B is a corporation that is not a trustee of a trust estate—the percentage of the issued share capital (however described) of the corporation held by person A;
  - (b) if person B is a partnership that is not a trustee of a trust estate—the percentage of the income of the partnership to which person A is entitled;

- (c) if person B is a trustee of a trust estate—the percentage in value of the trust estate in which person A is interested; or
  - (d) if person B is an entity that does not fall within any of paragraphs (a), (b) and (c)—the percentage of person A's ownership interest in the entity.
- (3) In applying subsection (1), if person A has an indirect beneficial interest in, or is indirectly entitled to exercise or control the exercise of voting rights in, person B through another person (*interposed person*), the extent of the beneficial interest or voting rights of person A in person B is—
- (a) if there is only one interposed person—the percentage arrived at by multiplying the percentage representing the extent of the beneficial interest or voting rights of person A in the interposed person by the percentage representing the extent of the beneficial interest or voting rights of the interposed person in person B; or
  - (b) if there is a series of 2, 3 or 4 interposed persons—the percentage arrived at by multiplying the percentage representing the extent of the beneficial interest or voting rights of person A in the first interposed person in the series by—
    - (i) the percentage representing the extent of the beneficial interest or voting rights of each interposed person (other than the last interposed person) in the series in the next interposed person in the series; and

- (ii) the percentage representing the extent of the beneficial interest or voting rights of the last interposed person in the series in person B.
- (4) In applying subsection (1)—
- (a) any indirect beneficial interest person A has in, or in relation to, person B through a series of 5 or more persons; and
  - (b) any voting rights person A is indirectly entitled to exercise, or control the exercise of, in or in relation to person B through a series of 5 or more persons, are not to be taken into account.
- (5) For the purposes of subsection (3)—
- (a) subsection (2) applies in determining the extent of the beneficial interest of person A in an interposed person as if the references to person B in subsection (2) were references to an interposed person;
  - (b) subsection (2) applies in determining the extent of the beneficial interest of an interposed person in person B as if the references to person A in subsection (2) were references to an interposed person; and
  - (c) subsection (2) applies in determining the extent of the beneficial interest of an interposed person (*interposed person X*) in another interposed person (*interposed person Y*) as if—
    - (i) the references to person A in subsection (2) were references to interposed person X; and
    - (ii) the references to person B in subsection (2) were references to interposed person Y.

- (6) In applying subsection (1)(b), the voting rights attributed to person A include all the voting rights of persons other than person A so far as they are required, or may be required, to be exercised in one or more of the following ways—
- (a) on behalf of person A;
  - (b) under the direction of person A;
  - (c) for the benefit of person A.
- (7) For the purposes of this section, if—
- (a) a reference is made to the exercise of the voting rights in a person; and
  - (b) the person is a corporation,
- the reference is to be read as a reference to the exercise of the voting rights at general meetings of the person.”
7. **Section 51C amended (business records to be kept)**
- (1) Before section 51C(5)(a)—
- Add**
- “(aa) section 15T (records to be kept);”.
- (2) Section 51C(5)(b)—
- Repeal the full stop**
- Substitute a semicolon.**
- (3) After section 51C(5)(b)—
- Add**
- “(c) section 9 of Schedule 17FC (qualifying IP income: nexus requirement for ascertaining excepted portion etc.).”

8. **Section 63C amended (amount of provisional salaries tax)**
- (1) Section 63C(1), after “subsections”—
- Add**
- “(1B),”.
- (2) Before section 63C(2)—
- Add**
- “(1B) In computing the amount of provisional salaries tax for a year of assessment, any credit or deduction allowed under section 50 for the preceding year of assessment is to be taken into account.”.
9. **Section 63H amended (amount of provisional profits tax)**
- (1) Section 63H(1), after “subsections”—
- Add**
- “(1E),”.
- (2) After section 63H(1D)—
- Add**
- “(1E) In computing the amount of provisional profits tax for a year of assessment, any credit or deduction allowed under section 50 for the preceding year of assessment is to be taken into account.”.
10. **Section 63M amended (amount of provisional property tax)**
- (1) Section 63M(1)—
- Repeal**
- “Provisional”
- Substitute**
- “Subject to subsection (1A), provisional”.

- (2) After section 63M(1)—

**Add**

“(1A) In computing the amount of provisional property tax for a year of assessment, any credit or deduction allowed under section 50 for the preceding year of assessment is to be taken into account.”.

**11. Section 80 amended (penalties for failure to make returns, making incorrect returns, etc.)**

- (1) After section 80(2V)—

**Add**

“(2W) A person who, without reasonable excuse, fails to comply with section 15K commits an offence and is liable on conviction to—

- (a) a fine at level 3; and
- (b) a further fine of treble the undercharged amount.

(2X) A person who, without reasonable excuse, fails to comply with section 8(2) of Schedule 17FC commits an offence and is liable on conviction to—

- (a) a fine at level 3; and
- (b) a further fine of treble the undercharged amount.”.

- (2) Before section 80(6)(a)—

**Add**

“(aa) section 15T (records to be kept);”.

- (3) Section 80(6)(b)—

**Repeal the full stop**

**Substitute a semicolon.**

- (4) After section 80(6)(b)—

**Add**

“(c) section 9 of Schedule 17FC (qualifying IP income: nexus requirement for ascertaining excepted portion etc.).”.

**12. Section 82A amended (additional tax in certain cases)**

- (1) After section 82A(1H)—

**Add**

“(1I) If—

- (a) a person, without reasonable excuse, fails to comply with section 15K; and
- (b) no prosecution for an offence under section 80 has been instituted in respect of the same facts,

the person is liable to be assessed under this section to additional tax of an amount not exceeding treble the undercharged amount.

(1J) If—

- (a) a person, without reasonable excuse, fails to comply with section 8(2) of Schedule 17FC; and
- (b) no prosecution for an offence under section 80 has been instituted in respect of the same facts,

the person is liable to be assessed under this section to additional tax of an amount not exceeding treble the undercharged amount.”.

- (2) After section 82A(4)(a)(i)(E)—

**Add**

“(F) for additional tax to be assessed under subsection (1I)—the alleged failure to comply with section 15K;

- (G) for additional tax to be assessed under subsection (1J)—  
the alleged failure to comply with section 8(2) of  
Schedule 17FC;”.

13. **Section 89 amended (transitional provisions)**

After section 89(28)—

**Add**

- “(29) Schedule 55 sets out transitional provisions that have  
effect for the purposes of the amendments to this  
Ordinance made by the Inland Revenue (Amendment)  
(Taxation on Specified Foreign-sourced Income)  
Ordinance 2022 ( of 2022).”.

14. **Schedule 17FC added**

After Schedule 17FB—

**Add**

**“Schedule 17FC**

[ss. 15M, 51C, 80 &  
82A & Sch. 55]

**Qualifying IP Income: Nexus Requirement for  
Ascertaining Excepted Portion etc.**

**Part 1**

**Preliminary**

**1. Interpretation of Schedule 17FC**

- (1) An expression used in this Schedule, and defined or  
otherwise explained in Division 3A of Part 4, has the same  
meaning as in that Division.

- (2) In this Schedule—

*excepted portion* (例外部分)—see section 3 of this Schedule;  
*non-Hong Kong resident person* (非香港居民人士) has the  
meaning given by section 50AAC(1);

*non-qualifying expenditure* (不合資格開支)—see section 6  
of this Schedule;

*qualifying intellectual property* (合資格知識產權) means—

- (a) a patent granted under the Patents Ordinance (Cap.  
514) (*Cap. 514*) or under the law of any place  
outside Hong Kong;
- (b) a patent application made under Cap. 514 or under  
the law of any place outside Hong Kong; or
- (c) a copyright subsisting in software under the  
Copyright Ordinance (Cap. 528) or under the law of  
any place outside Hong Kong;

*qualifying IP income* (合資格知識產權收入) means income  
derived from qualifying intellectual property in respect  
of—



- (a) the exhibition or use of, or a right to exhibit or use, (whether in or outside Hong Kong) the property; or
- (b) the imparting of, or undertaking to impart, knowledge directly or indirectly connected with the use (whether in or outside Hong Kong) of the property;

*qualifying R&D expenditure* (合資格研發開支)—see section 5 of this Schedule;

*R&D activity* (研發活動) has the meaning given by section 2 of Schedule 45;

*R&D fraction* (研發分數)—see section 4 of this Schedule;

*specified period* (指明期間), in relation to an MNE entity to which any qualifying IP income accrues, means the period—

- (a) beginning on 1 January 2023 or on an earlier date elected by the entity; and
- (b) ending on the last day of the entity's basis period of the year of assessment during which the income accrues.

(3) For the purposes of this Schedule—

- (a) a person is to be regarded as associated with another person if, as between them, the participation condition is met under section 50AAG; and
- (b) a reference to associated person is to be read accordingly.

## 2. Consistency with OECD 2015 Report

- (1) This Schedule is to be read in the way that best secures consistency with the requirements and guidance in Chapter 4 of the OECD 2015 Report.

(2) In this section—

*OECD 2015 Report* (《經合組織 2015 年報告》) means the Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 - 2015 Final Report published by the Organisation for Economic Co-operation and Development in 2015.

## Part 2

### Excepted Portion of Qualifying IP Income

#### 3. Ascertaining excepted portion

The excepted portion of qualifying IP income received by an MNE entity is to be ascertained in accordance with the following formula—

$$P = I \times F$$

where: P means the excepted portion;

I means the qualifying IP income; and

F means the R&D fraction applicable to the qualifying IP income.

#### 4. Ascertaining R&D fraction

- (1) The R&D fraction applicable to qualifying IP income received by an MNE entity is to be ascertained in accordance with the following formula—

$$F = \frac{QE \times 130\%}{QE + NE}$$

where: F means the R&D fraction;

QE means the qualifying R&D expenditure incurred in respect of the qualifying intellectual property to which the qualifying IP income relates (*subject intellectual property*); and

NE means the non-qualifying expenditure incurred in respect of the subject intellectual property.

- (2) However, an R&D fraction is to be regarded as 100% if the percentage ascertained in accordance with subsection (1) is more than 100%.

#### 5. Meaning of QE: qualifying R&D expenditure

- (1) This section explains the meaning of *qualifying R&D expenditure* in relation to qualifying IP income received by an MNE entity.
- (2) Any expenditure (including capital expenditure) incurred by the MNE entity during the specified period for an R&D activity that—
- (a) is connected to the qualifying intellectual property to which the qualifying IP income relates (*subject intellectual property*); and
  - (b) is carried out—
    - (i) by the MNE entity;
    - (ii) on behalf of the MNE entity by a person that is not associated with the MNE entity; or
    - (iii) in Hong Kong on behalf of the MNE entity by an associated person of the MNE entity that is a Hong Kong resident person,

is, subject to subsections (3), (4), (5) and (6), a qualifying R&D expenditure incurred in respect of the subject intellectual property.

- (3) The following expenditures are not to be regarded as qualifying R&D expenditures—
- (a) interest payments;
  - (b) payments for any land or building, or for any alteration, addition or extension to any building;
  - (c) any expenditure (including capital expenditure) incurred by the MNE entity for obtaining from another person (whether by acquisition, licensing, amalgamating with another company or otherwise) the subject intellectual property.
- (4) Subsection (5) applies if—
- (a) the subject intellectual property is or was owned by another company that is a Hong Kong resident person (*original owner*);
  - (b) the MNE entity—
    - (i) obtained the property by amalgamating with the original owner; or
    - (ii) acquired all equity interests in the original owner and subsequently acquired, or obtained a licence for, the property from the original owner; and
  - (c) the original owner has sufficient records of the expenditures it incurred in respect of the property, so that the MNE entity would still be able to comply with section 51C (as modified by section 9(2) and (3) of this Schedule) in respect of the expenditures even if—

- (i) the references to the MNE entity in subsections (2) and (3)(c) were regarded as including the original owner; and
  - (ii) as a result, the expenditures became qualifying R&D expenditures.
- (5) Subsections (2) and (3)(c) apply as if the references to the MNE entity in those subsections included the original owner.
- (6) If, in addition to the subject intellectual property, a qualifying R&D expenditure is also connected to other items of intellectual property (including other qualifying intellectual property), the expenditure is to be apportioned between the subject intellectual property and those other items on a just and reasonable basis.
- (7) For the purposes of subsection (6), an expenditure is apportioned between the subject intellectual property and other items on a just and reasonable basis if the amount apportioned to the subject intellectual property represents the extent to which the expenditure was incurred in respect of the property.

**6. Meaning of NE: non-qualifying expenditure**

- (1) This section explains the meaning of *non-qualifying expenditure* in relation to qualifying IP income received by an MNE entity.
- (2) Each of the following expenditures is, subject to subsections (3), (4), (5), (6) and (7), a non-qualifying expenditure incurred in respect of the qualifying intellectual property to which the qualifying IP income relates (*subject intellectual property*)—

- (a) any expenditure (including capital expenditure) incurred by the MNE entity during the specified period for obtaining from another person (whether by acquisition, licensing, amalgamating with another company or otherwise) the subject intellectual property;
  - (b) any expenditure (including capital expenditure) incurred by the MNE entity during the specified period for an R&D activity that—
    - (i) is connected to the subject intellectual property; and
    - (ii) is carried out—
      - (A) on behalf of the MNE entity by an associated person of the MNE entity that is a non-Hong Kong resident person; or
      - (B) outside Hong Kong on behalf of the MNE entity by an associated person of the MNE entity that is a Hong Kong resident person.
- (3) The following expenditures are not to be regarded as non-qualifying expenditures—
- (a) interest payments;
  - (b) payments for any land or building, or for any alteration, addition or extension to any building.
- (4) Subsections (5) and (6) apply if—
- (a) the subject intellectual property is or was owned by another company that is a Hong Kong resident person (*original owner*);
  - (b) the MNE entity—

- (i) obtained the property by amalgamating with the original owner; or
  - (ii) acquired all equity interests in the original owner and subsequently acquired, or obtained a licence for, the property from the original owner; and
- (c) the original owner has sufficient records of the expenditures it incurred in respect of the property, so that the MNE entity would still be able to comply with section 51C (as modified by section 9(2) and (3) of this Schedule) in respect of the expenditures even if—
- (i) the references to the MNE entity in subsection (2) were regarded as including the original owner; and
  - (ii) as a result, the expenditures became non-qualifying expenditures.
- (5) Subsection (2) applies as if the references to the MNE entity in that subsection included the original owner.
- (6) In calculating the total amount of non-qualifying expenditures, the expenditure incurred by the MNE entity during the specified period for obtaining the subject intellectual property from the original owner is to be deducted.
- (7) If, in addition to the subject intellectual property, a non-qualifying expenditure is also connected to other items of intellectual property (including other qualifying intellectual property), the expenditure is to be apportioned between the subject intellectual property and those other items on a just and reasonable basis.

- (8) For the purposes of subsection (7), an expenditure is apportioned between the subject intellectual property and other items on a just and reasonable basis if the amount apportioned to the subject intellectual property represents the extent to which the expenditure was incurred in respect of the property.

### Part 3

## Supplementary Provisions for Qualifying IP Income

7. **Setting off loss sustained in respect of qualifying intellectual property**
- (1) This section applies if—
- (a) any qualifying IP income received by an MNE entity is chargeable to profits tax for a year of assessment because of section 15J(1); and
  - (b) during the basis period of that year of assessment, a loss is sustained in respect of the qualifying intellectual property to which the income relates.
- (2) The qualifying portion of the loss may be set off against the MNE entity's assessable profits for that year of assessment.
- (3) Any amount of the qualifying portion of the loss not so set off may be carried forward and set off, in accordance with section 19C, against the MNE entity's assessable profits for subsequent years of assessment.
- (4) The qualifying portion of a loss sustained in respect of qualifying intellectual property is to be ascertained in accordance with the following formula—

$$QP = L \times (1 - F)$$

where: QP means the qualifying portion;

L means the loss; and

F means the R&D fraction applicable to the qualifying IP income to which the qualifying intellectual property relates.

- (5) To avoid doubt, the non-qualifying portion of a loss sustained in respect of qualifying intellectual property must not be set off against any assessable profits of the MNE entity.
- (6) The non-qualifying portion of a loss sustained in respect of qualifying intellectual property is to be ascertained in accordance with the following formula—

$$NP = L \times F$$

where: NP means the non-qualifying portion;

L means the loss; and

F means the R&D fraction applicable to the qualifying IP income to which the qualifying intellectual property relates.

#### 8. Effect of withdrawal, abandonment and refusal of patent application

- (1) This section applies if—
  - (a) because of section 15M, section 15J(1) does not operate in relation to the excepted portion of qualifying IP income received by an MNE entity in a year of assessment;

- (b) the income is derived from a patent application made under the Patents Ordinance (Cap. 514) or under the law of any place outside Hong Kong; and
  - (c) the application is withdrawn, abandoned or refused in a subsequent year of assessment.
- (2) The MNE entity must notify the Commissioner in writing of the withdrawal, abandonment or refusal within 4 months after the end of the basis period of that subsequent year of assessment, unless the entity has already been required to furnish a return under section 51(1).
- (3) Section 15J(1) applies to the excepted portion of the qualifying IP income as if it were specified foreign-sourced income received in Hong Kong during the basis period of that subsequent year of assessment.

#### 9. Records to be kept

- (1) Without limiting section 15T, section 51C applies, with the modifications specified in subsections (2) and (3), to an MNE entity that relies on section 15M to claim that section 15J(1) does not operate in relation to the excepted portion of qualifying IP income it receives.
- (2) The MNE entity must retain records of transactions, acts or operations relating to the qualifying IP income under section 51C at least until the later of the following—
  - (a) the expiry of 7 years after the completion of those transactions, acts or operations; or
  - (b) the expiry of 7 years after making the claim mentioned in subsection (1).
- (3) The MNE entity must keep records of the following, in addition to records within the meaning of section 51C(3) and (4)—

- (a) information sufficient to establish that the income concerned is qualifying IP income;
  - (b) details of all corresponding expenditures incurred;
  - (c) details of the qualifying intellectual property to which the income relates;
  - (d) if an apportionment is made under section 5(6) or 6(7) of this Schedule—information sufficient to establish that the apportionment is made on a just and reasonable basis;
  - (e) if a loss is set off under section 7 of this Schedule—details of the loss.
- (4) To avoid doubt, the records mentioned in subsection (3) are records of transactions, acts or operations relating to the qualifying IP income.
- (5) Section 80 applies to a failure to comply with section 51C as modified by subsections (2) and (3) in the same way section 80 applies to a failure to comply with section 51C.
- (6) In this section—
- corresponding expenditures* (相應開支), in relation to qualifying IP income, means all of the following expenditures—
- (a) qualifying R&D expenditures incurred in respect of the qualifying intellectual property to which the income relates;
  - (b) non-qualifying expenditures incurred in respect of the qualifying intellectual property to which the income relates;
  - (c) any other expenditures incurred in producing the income.

**10. Transitional arrangement for MNE entity with insufficient records**

- (1) This section applies if—
- (a) qualifying IP income accrues to an MNE entity during the period—
    - (i) beginning on 1 January 2023; and
    - (ii) ending on the last day of the entity's basis period of the year of assessment beginning on 1 April 2024; and
  - (b) the entity is unable to ascertain the R&D fraction applicable to the income under Part 2 of this Schedule because there are insufficient records.
- (2) For ascertaining the R&D fraction and keeping records, the MNE entity may elect that sections 5, 6 and 9 of this Schedule apply on the following basis—
- (a) the references to “specified period” in sections 5(2) and 6(2)(a) and (b) of this Schedule are to be regarded as references to the period of 3 years ending on the last day of the entity's basis period of the year of assessment during which the qualifying IP income accrues;
  - (b) the references to “the subject intellectual property” in sections 5(3)(c) and 6(2)(a) of this Schedule are to be regarded as references to any intellectual property;
  - (c) the following provisions of this Schedule are to be omitted—
    - (i) section 5(2)(a), (4), (5), (6) and (7);
    - (ii) section 6(2)(b)(i), (4), (5), (6), (7) and (8);

(iii) section 9(3)(d).”.

15. **Schedule 17G amended (meaning of *permanent establishment* in Hong Kong)**

Schedule 17G, after “[ss.]—

**Add**

“15H, 15I.”.

16. **Schedule 45 amended (deduction of R&D expenditures)**

Schedule 45—

**Repeal**

“Sch.”

**Substitute**

“Schs. 17FC &”.

17. **Schedules 54 and 55 added**

After Schedule 53—

**Add**

**“Schedule 54**

[s. 50AAA]

**Specifications for Section 50AAA in relation to  
Unilateral Tax Credits**

**Part 1**

**Preliminary**

**1. Interpretation of Schedule 54**

In this Schedule—

*adequate interest* (足夠權益)—see section 50AAAC;

*Hong Kong resident person* (香港居民人士) has the meaning given by section 50AAC(1);

*resident for tax purposes* (稅務居民) has the meaning given by section 50AAC(1);

*similar tax* (類似稅項) has the meaning given by section 50AAA(7);

*specified foreign-sourced income* (指明外地收入) has the meaning given by section 15H(1).

**Part 2**

**Specifications for Section 50AAA**

**2. Specified foreign-sourced income**

(1) For the purposes of section 50AAA(2)—

(a) the following income is specified: specified foreign-sourced income; and

- (b) the following condition is specified for the income: the income is chargeable to profits tax because of section 15J(1).
- (2) For the purposes of section 50AAA(3), the following modification is specified for applying section 50 in relation to the similar tax payable in respect of specified foreign-sourced income: section 50(1A)(a)(ii) and (1B) is to be omitted.
- (3) For the purposes of section 50AAA(3)(a)(i), the following provisions are specified for the similar tax payable in respect of specified foreign-sourced income—
- (a) the similar tax is to be allowed as a credit (*tax credit*) against the profits tax payable in respect of the income in Hong Kong;
- (b) if—
- (i) the income is a dividend received by a Hong Kong resident person (*subject person*) from a company that is resident for tax purposes in the territory concerned (*investee company*);
- (ii) the dividend is paid out of the investee company's profits; and
- (iii) at the time the dividend accrues, the subject person has an adequate interest in the investee company,
- the tax credit allowed to the subject person is, subject to paragraph (c), to include any similar tax payable in respect of the profits in the territory;
- (c) only the portion of the similar tax that represents the extent of—

- (i) the direct or indirect beneficial interest the subject person has in, or in relation to, the investee company; or
- (ii) the voting rights the subject person is (whether directly or indirectly) entitled to exercise, or control the exercise of, in or in relation to the investee company,
- as ascertained when determining whether the subject person has an adequate interest in the investee company, is to be included in the tax credit.
- (4) For the purposes of section 50AAA(4), the following transitional arrangement is specified for the specification of specified foreign-sourced income under subsection (1)(a): section 50AAA applies in relation to profits tax payable for a year of assessment beginning on or after 1 April 2022 in respect of income accrued and received on or after 1 January 2023.
- (5) For the purposes of the definition of *similar tax* in section 50AAA(7), the following tax is specified: profits tax.

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## Schedule 55

[s. 89(29)]



## Transitional Provisions for Inland Revenue (Amendment) (Taxation on Specified Foreign- sourced Income) Ordinance 2022

### 1. Interpretation of Schedule 55

In this Schedule—

*specified foreign-sourced income* (指明外地收入) has the meaning given by section 15H(1).

### 2. Transitional arrangements

- (1) Division 3A of Part 4 and Schedule 17FC apply in relation to specified foreign-sourced income accrued and received on or after 1 January 2023.
- (2) Without limiting subsection (1), section 7 of Schedule 17FC and section 15Q apply in relation to losses sustained on or after 1 January 2023.
- (3) Sections 50(7A) and (7B) and 50AAAB apply in relation to tax payable for a year of assessment beginning on or after 1 April 2022 in respect of income accrued and received on or after 1 January 2023.
- (4) The amendments made to sections 63C, 63H and 63M by the Inland Revenue (Amendment) (Taxation on Specified Foreign-sourced Income) Ordinance 2022 ( of 2022) apply in relation to provisional tax payable for a year of assessment beginning on or after 1 April 2023.”.

## Explanatory Memorandum

The objects of this Bill are—

- (a) to amend the Inland Revenue Ordinance (Cap. 112) (*principal Ordinance*)—
    - (i) to provide that certain foreign-sourced income is to be regarded as arising in or derived from Hong Kong; and
    - (ii) to provide for relief against double taxation in respect of certain foreign-sourced income; and
  - (b) to provide for related and transitional matters.
2. The Bill contains 17 clauses.
  3. Clause 1 sets out the short title and provides for commencement.
  4. Clause 2 is the standard enactments amended clause included in amending legislation.
  5. Clause 3 adds a new Division 3A to Part 4 of the principal Ordinance. This new Division contains provisions in relation to foreign-sourced income (new sections 15H to 15T).
  6. The new sections 15H and 15I contain the definitions for the interpretation of the new Division. In particular, the new section 15H(1) defines *specified foreign-sourced income* to mean any interest, dividend, disposal gain or intellectual property income arising in or derived from a territory outside Hong Kong, not including any interest, dividend or disposal gain derived by a regulated financial entity from the carrying on of a business as such a regulated financial entity.
  7. The new section 15J provides that any specified foreign-sourced income that—

- (a) is received in Hong Kong by a multinational enterprise entity (*MNE entity*) carrying on a trade, profession or business in Hong Kong; and
- (b) is not otherwise chargeable to profits tax under Part 4 of the principal Ordinance,

is to be regarded as a receipt arising in or derived from Hong Kong and is to be regarded as not arising from the sale of capital assets even if it so arises.

8. The new section 15K provides that, if an MNE entity is chargeable to profits tax in respect of any specified foreign-sourced income under Part 4 of the principal Ordinance because of the new section 15J(1), the entity must notify the Commissioner of Inland Revenue of this fact in writing.
9. The new section 15L provides that the new section 15J(1) does not operate in relation to specified foreign-sourced income received in Hong Kong by an MNE entity if—
  - (a) the income is interest, a dividend or a disposal gain; and
  - (b) the entity has economic substance in Hong Kong.
10. The new section 15M, together with the new Schedule 17FC added by clause 14, provides that, if the specified foreign-sourced income is intellectual property income (*qualifying IP income*) derived from a patent, patent application or copyright subsisting in software (*qualifying intellectual property*), the new section 15J(1) does not operate in relation to the excepted portion of the income. The excepted portion is to be ascertained under the new Schedule 17FC. This new Schedule also provides for—
  - (a) the setting off of losses sustained in respect of qualifying intellectual property;
  - (b) the effect of withdrawal, abandonment and refusal of patent applications; and

- (c) the records to be kept for qualifying IP income, including a transitional arrangement for MNE entities with insufficient records.
11. The new section 15N provides that the new section 15J(1) also does not operate if—
    - (a) the MNE entity receiving the specified foreign-sourced income concerned is a Hong Kong resident person or has a permanent establishment in Hong Kong;
    - (b) the income is a dividend or disposal gain; and
    - (c) the MNE entity has continuously held not less than 5% of equity interests in the investee entity for a period of not less than 12 months immediately before the specified foreign-sourced income accrues.
  12. The new section 15O provides that the new section 15N does not apply in certain circumstances.
  13. The new section 15P gives the meaning of *direct investee entity* and *indirect investee entity*.
  14. The new section 15Q provides that a loss sustained overseas by an MNE entity may be set off against the entity's assessable profits, but only to the extent that the assessable profits are derived from specified foreign-sourced income that is chargeable to profits tax because of the new section 15J(1).
  15. The new section 15R provides that outgoings and expenses incurred in the production of specified foreign-sourced income may be deducted.
  16. The new section 15S provides that balancing charges and allowances under Part 6 of the principal Ordinance that relate to specified foreign-sourced income may be taken into account under sections 18F and 19E of the principal Ordinance.

17. The new section 15T requires an MNE entity to retain certain records if it receives in Hong Kong any specified foreign-sourced income to which the new section 15J(1) applies.
18. Clause 4 makes a related amendment to section 16(2J) of the principal Ordinance in view of the amendments made to section 50 of the principal Ordinance and the addition of the new sections 50AAA, 50AAAB and 50AAAC to the principal Ordinance.
19. Clause 5 amends section 50 of the principal Ordinance so that, if any double taxation arrangements contain a provision that foreign tax payable in respect of the underlying profits of a dividend is to be taken into account in determining the amount of credit and (if any) deduction to be allowed in respect of the dividend, the provision is to have effect.
20. Clause 6 adds new sections 50AAA, 50AAAB and 50AAAC to the principal Ordinance. The new section 50AAA sets up a framework for unilateral tax credits to be allowed. Details of unilateral tax credits are provided in the new Schedule 54 added by clause 17.
21. The new section 50AAAB provides that, against profits tax payable in Hong Kong in respect of a dividend (*subject dividend*), unilateral tax credits are to be allowed for any similar tax payable in a territory outside Hong Kong in respect of any underlying profits, underlying dividends, downstream profits and downstream dividends to which the subject dividend relates. Those tax credits are allowed even if the double taxation arrangements made do not contain a provision to that effect. However, for the new section 50AAAB to apply, the person receiving the subject dividend must have an adequate interest in the company distributing the subject dividend.
22. The new section 50AAAC gives the meaning of *adequate interest*.
23. Clause 7 makes related amendments to section 51C of the principal Ordinance.

24. Clauses 8, 9 and 10 respectively amend sections 63C, 63H and 63M of the principal Ordinance so that any tax credit or deduction allowed under the amended section 50 of the principal Ordinance is to be taken into account in computing the amount of provisional salaries tax, provisional profits tax and provisional property tax.
25. Clauses 11 and 12 respectively make related amendments to sections 80 and 82A of the principal Ordinance in view of the addition of the new sections 15K and 15T and the new Schedule 17FC to the principal Ordinance.
26. Clauses 15 and 16 respectively make minor related amendments to Schedules 17G and 45 to the principal Ordinance.
27. Clauses 13 and 17 respectively add a new section 89(29) and new Schedules 54 and 55 to the principal Ordinance. The new section 89(29) and new Schedule 55 provide for transitional arrangements.

**16. Ascertainment of chargeable profits**

- (1) In ascertaining the profits in respect of which a person is chargeable to tax under this Part for any year of assessment there shall be deducted all outgoings and expenses to the extent to which they are incurred during the basis period for that year of assessment by such person in the production of profits in respect of which he is chargeable to tax under this Part for any period, including—
- (a) where the condition for the application of this paragraph is satisfied under subsection (2), and subject to subsections (2A), (2B), (2C), (2CA) and (2CC), sums payable by such person by way of interest on any money borrowed by him for the purpose of producing such profits, and sums payable by such person by way of legal fees, procuration fees, stamp duties and other expenses in connection with such borrowing; (*Replaced 2 of 1971 s. 11. Amended 36 of 1984 s. 4; 12 of 2004 s. 6; 12 of 2016 s. 8*)
  - (b) rent paid by any tenant of land or buildings occupied by him for the purpose of producing such profits, but not exceeding, in the case of rent paid to the tenant's spouse, or by a partnership to one or more of the partners thereof or to a spouse of any such partner, an amount equal to the assessable value of the land or buildings; (*Amended 76 of 1975 s. 8; 8 of 1983 s. 11; 71 of 1983 s. 14*)
  - (c) subject to subsection (2J) and section 50AA, tax of substantially the same nature as tax imposed under this Ordinance, proved to the satisfaction of the Commissioner to have been paid in a territory outside Hong Kong (whether by deduction or otherwise) by any corporation or by a person other than a corporation who carries on a trade, profession or business in Hong Kong, during the basis period for the year of assessment in respect of profits chargeable to tax by virtue of section 15(1)(f), (g), (i), (ia), (ib), (j), (k), (l), (la) or (lb); (*Amended 7 of 1986 s. 12; 19 of 1986 s. 3; 63 of 1997 s. 2(a); 12 of 2016 s. 8; 27 of 2018 s. 4; 18 of 2021 s. 14*)

- (ca) subject to subsection (2J) and section 50AA, specified tax that is proved to the satisfaction of the Commissioner to have been paid in a territory outside Hong Kong (whether by deduction or otherwise) by any person who carries on a trade, profession or business in Hong Kong during the basis period for the year of assessment in respect of profits chargeable to tax under this Part; (*Added 18 of 2021 s. 14*)
- (d) bad debts incurred in any trade, business or profession, proved to the satisfaction of the assessor to have become bad during the basis period for the year of assessment, and doubtful debts to the extent that they are respectively estimated to the satisfaction of the assessor to have become bad during the said basis period notwithstanding that such bad or doubtful debts were due and payable prior to the commencement of the said basis period:  
Provided that—
- (i) deductions under this paragraph shall be limited to debts which were included as a trading receipt in ascertaining the profits, in respect of which the person claiming the deduction is chargeable to tax under this Part, of the period within which they arose, and debts in respect of money lent, in the ordinary course of the business of the lending of money within Hong Kong, by a person who carries on that business; (*Amended 7 of 1986 s. 12*)
- (ii) all sums recovered during the said basis period on account of amounts previously allowed in respect of bad or doubtful debts shall for the purposes of this Ordinance be treated as part of the profits of the trade, business or profession for that basis period;
- (e) expenditure incurred in the repair of any premises, plant, machinery, implement, utensil or article employed in the production of such profits;
- (f) expenditure incurred in the replacement of any implement, utensil or article employed in the production of such profits:  
Provided that no allowances have been or shall be made under the provisions of Part 6 in respect of such implement, utensil or article;

- (g) despite section 17, a sum expended for the registration of a trade mark or design, or the registration or grant of a patent or plant variety right, used in the trade, profession or business which produces such profits; *(Replaced 26 of 1969 s. 14. Amended 52 of 1997 s. 160; 24 of 2018 s. 4; 29 of 2018 s. 6)*
- \*(ga) the payments and expenditure specified in sections 16AA, 16C, 16E, 16EA, 16F, 16G and 16I, as provided in those sections; *(Added 35 of 1965 s. 9. Amended 56 of 1993 s. 9; 31 of 1998 s. 8; 32 of 1998 s. 6; 21 of 2011 s. 4; 29 of 2018 s. 6)*
- (gb) despite section 17, any deduction allowed under section 16B; *(Added 29 of 2018 s. 6)*
- (h) such other deductions as may be prescribed by any rule made under this Ordinance.

**Note—**

See also subsections (3D). *(Added 5 of 2020 s. 8)*

- (1A) In computing the amount of deduction of a person's outgoings and expenses for the purposes of subsection (1), if—
  - (a) the person is a connected person of a corporation;
  - (b) a sum is payable by the person to the corporation, whether directly or through an interposed person; and
  - (c) the sum is included in the assessable profits of the corporation chargeable at a reduced tax rate under section 14B(1), 14D(1), 14H(1), 14J(1), 14P(1), 14T(1), 14ZD(1), 14ZM(1) or 14ZV(1) for a year of assessment, *(Amended 27 of 2018 s. 30; 5 of 2020 s. 8; 10 of 2022 s. 5)*

the amount of deduction in respect of the sum is to be reduced such that the profits tax payable by the person is increased by reference to the amount of the reduction in the profits tax payable by the corporation in respect of the sum for the year of assessment or any subsequent year of assessment. *(Added 9 of 2017 s. 6)*

- (1B) However, subsection (1A) does not apply in relation to a person for a year of assessment if, had the sum mentioned in subsection (1A)(b) not been so payable, it would have been included in the assessable profits of the person chargeable at a reduced rate under section 14B(1), 14D(1), 14H(1), 14J(1), 14P(1), 14T(1), 14ZD(1), 14ZM(1) or 14ZV(1) for the year of assessment. *(Added 27 of 2018 s. 30. Amended 5 of 2020 s. 8; 10 of 2022 s. 5)*

- (1C) For subsection (1A), a person is a connected person of a corporation if the person is—
- (a) an associated corporation of the corporation; or
  - (b) a person (other than a corporation)—
    - (i) over whom the corporation has control;
    - (ii) who has control over the corporation; or
    - (iii) who is under the control of the same person as is the corporation. (*Added 27 of 2018 s. 30*)
- (1D) For subsection (1A), a person is also a connected person of a corporation in relation to a case where a sum is included in the corporation's assessable profits chargeable at a reduced rate under section 14H(1), 14J(1), 14P(1), 14T(1), 14ZD(1), 14ZM(1) or 14ZV(1) for a year of assessment if the person is a partnership in which the corporation or its associate (as defined by section 14G(1) or 14O(1) or section 1(1) of Schedule 17FB (whichever is applicable)) is a partner. (*Added 27 of 2018 s. 30. Amended 5 of 2020 s. 8; 10 of 2022 s. 5*)
- (2) The condition for the application of subsection (1)(a) is satisfied if— (*Amended 12 of 2004 s. 6*)
- (a) the money has been borrowed by a financial institution;
  - (ab) the money has been borrowed by a LAC banking entity by way of issuing a regulatory capital security; (*Added 4 of 2019 s. 7*)
  - (b) the money has been borrowed by a public utility company specified in Schedule 3 at a rate of interest not exceeding the rate specified by the Financial Secretary by notice in the Gazette; (*Amended 17 of 1989 s. 5*)
  - (c) the money has been borrowed from a person other than a financial institution or an overseas financial institution and the sums payable by way of interest are chargeable to tax under this Ordinance;
  - (d) the money has been borrowed from a financial institution or an overseas financial institution; (*Replaced 12 of 2004 s. 6*)
  - (e) the money has been borrowed wholly and exclusively to finance—
    - (i) capital expenditure incurred by the borrower on the provision of—
      - (A) any machinery or plant, where the expenditure qualifies for an allowance under Part 6;

- (B) any machinery or plant for R&D activities within the meaning of section 2 of Schedule 45, where the expenditure may be deducted under section 16B; (*Amended 29 of 2018 s. 6*)
  - (C) a prescribed fixed asset (as defined in section 16G(6)), where the expenditure may be deducted under section 16G; or
  - (D) any environmental protection machinery or environment-friendly vehicle (as defined in section 16H(1)), where the expenditure may be deducted under section 16I; or (*Replaced 4 of 2010 s. 4. Amended 10 of 2010 s. 2*)
- (ii) the purchase of trading stock by the borrower, where the trading stock purchased is used by the borrower in the production of profits chargeable to tax under this Part,
- and—
- (iii) the lender is not an associate of the borrower; and
  - (iv) where the lender is a trustee of a trust estate or a corporation controlled by such a trustee, neither the trustee nor the corporation nor any beneficiary under the trust is the borrower or an associate of the borrower; (*Replaced 12 of 2004 s. 6. Amended 12 of 2016 s. 8*)
- (f) the borrower is a corporation and the deduction claimed is in respect of interest payable by it—
- (i) on debentures listed on a stock exchange in Hong Kong or on any other stock exchange recognized by the Commissioner for the purposes of this subparagraph;
  - (ii) on instruments (other than debentures described in subparagraph (i))—
    - (A) issued bona fide and in the course of carrying on business and marketed in Hong Kong or in a major financial centre outside Hong Kong recognized by the Commissioner for the purposes of this sub-subparagraph; or



- (B) issued pursuant to any agreement or arrangements, where the issue of an advertisement, invitation or document in respect of the agreement or arrangements has been authorized by the Securities and Futures Commission under section 105 of the Securities and Futures Ordinance (Cap. 571), and the advertisement, invitation or document has been issued to the public; or
- (iii) on money borrowed from an associated corporation of the borrower, where the money borrowed in the hands of the associated corporation arises entirely from the proceeds of an issue by the associated corporation of debentures described in subparagraph (i) or of instruments described in subparagraph (ii), in an amount not exceeding the interest payable by the associated corporation to the holders of such debentures or instruments; or *(Replaced 12 of 2004 s. 6. Amended 12 of 2016 s. 8)*
- (g) the borrower is a corporation carrying on in Hong Kong an intra-group financing business and—
  - (i) the deduction claimed is in respect of interest payable by it on money borrowed from a non-Hong Kong associated corporation (*lender*) in the ordinary course of that business;
  - (ii) the lender is, in respect of the interest, subject to a similar tax in a territory outside Hong Kong at a rate that is not lower than the reference rate; and
  - (iii) the lender's right to use and enjoy that interest is not constrained by a contractual or legal obligation to pass that interest to any other person, unless the obligation arises as a result of a transaction between the lender and a person other than the borrower dealing with each other at arm's length.

**Note—**

See subsection (2I) for elaboration on how a person is regarded as subject to a tax at a certain rate and the meanings of *similar tax* and *reference rate*. *(Added 12 of 2016 s. 8)*

- (2AA) Subsections (1)(a) and (2)(a) apply, subject to sections 17B, 17C, 17D, 17E, 17F and 17G, in relation to a sum payable by a financial institution in respect of a regulatory capital security issued by the financial institution. *(Added 12 of 2016 s. 13)*

(2AAB) Subsections (1)(a) and (2)(ab) apply, subject to sections 17B, 17C, 17D, 17E and 17F, in relation to a sum payable by a LAC banking entity in respect of a regulatory capital security issued by the entity. *(Added 4 of 2019 s. 7)*

(2A) Where—

- (a) the condition for the application of subsection (1)(a) is satisfied under subsection (2)(c), (d) or (e);
- (b) at any time during the basis period of the borrower for the year of assessment concerned, the payment of any sum payable by way of principal or interest in respect of the money borrowed is secured or guaranteed, whether wholly or in part and whether directly or indirectly, by a deposit or loan made by the borrower or an associate of the borrower with or to—
  - (i) the lender or an associate of the lender;
  - (ii) a financial institution or an associate of a financial institution; or
  - (iii) an overseas financial institution or an associate of an overseas financial institution; and
- (c) any sum payable by way of interest on the deposit or loan is not chargeable to tax under this Ordinance,

the amount of the deduction which, but for this subsection and subsections (2B), (2C) and (2CA), would have been allowed under subsection (1)(a) for the year of assessment concerned in respect of sums payable by the borrower by way of interest on the money borrowed shall be reduced, having regard to the sum payable by way of interest on the deposit or loan, by an amount calculated on such basis as is most reasonable and appropriate in the circumstances of the case. *(Added 12 of 2004 s. 6. Amended 12 of 2016 s. 8)*

(2B) Where—

- (a) the condition for the application of subsection (1)(a) is satisfied under subsection (2)(c), (d) or (e); and

- (b) at any time during the basis period of the borrower for the year of assessment concerned, arrangements are in place, whether between the borrower and the lender or otherwise, whereby any sum payable by way of interest on the money borrowed or on any part of the money borrowed is payable, whether directly or through any interposed person, to the borrower or to a person (other than the lender) who is connected with the borrower and in either case the borrower or the person, as the case may be, is not an excepted person as defined in subsection (2E)(c),

the amount of the deduction which, but for this subsection and subsections (2A) , (2C) and (2CA), would have been allowed under subsection (1)(a) for the year of assessment concerned in respect of sums payable by the borrower by way of interest on the money borrowed or on the relevant part of the money borrowed, as the case may be, shall be reduced by an amount calculated in accordance with the following formula—  
*(Amended 12 of 2016 s. 8)*

$$\frac{A}{B} \times C$$

- where:
- A means the total number of days during the basis period of the borrower for the year of assessment concerned, at the end of each of which the principal in respect of the money borrowed or in respect of the relevant part of the money borrowed, as the case may be, is outstanding and the arrangements are in place;
  - B means the total number of days during the basis period of the borrower for the year of assessment concerned, at the end of each of which the principal in respect of the money borrowed or in respect of the relevant part of the money borrowed, as the case may be, is outstanding; and

C means the total amount of sums payable by the borrower by way of interest on the money borrowed or on the relevant part of the money borrowed, as the case may be, which, but for this subsection and subsections (2A) , (2C) and (2CA), would have been deductible under subsection (1) (a) for the year of assessment concerned. *(Added 12 of 2004 s. 6. Amended 12 of 2016 s. 8)*

(2C) Subject to subsection (2G), where—

- (a) the condition for the application of subsection (1)(a) is satisfied under subsection (2)(f); and
- (b) at any time during the basis period of the borrower for the year of assessment concerned, arrangements are in place, whether between the borrower and the holders of the debentures or instruments concerned or otherwise, whereby any sum payable by way of interest on the debentures or instruments concerned or on any interest in the debentures or instruments concerned is payable, whether directly or through any interposed person, to the borrower or to a person who is connected with the borrower and in either case the borrower or the person, as the case may be, is not an excepted person as defined in subsection (2F)(c),

the amount of the deduction which, but for this subsection and subsections (2A) , (2B) and (2CA), would have been allowed under subsection (1)(a) for the year of assessment concerned in respect of— *(Amended 12 of 2016 s. 8)*

- (c) (where the condition for the application of subsection (1) (a) is satisfied under subsection (2)(f)(i) or (ii)) the sum payable by the borrower by way of interest on the debentures or instruments concerned or on the relevant interest in the debentures or instruments concerned, as the case may be; or
- (d) (where the condition for the application of subsection (1) (a) is satisfied under subsection (2)(f)(iii)) the sum payable by the borrower by way of interest on money borrowed from the associated corporation, being money arising entirely from the proceeds of the issue of the debentures or instruments concerned or of the relevant interest in the debentures or instruments concerned, as the case may be,

shall be reduced by an amount calculated in accordance with the following formula—

$$\frac{X}{Y} \times Z$$

- where:
- X means the total number of days during the basis period of the borrower for the year of assessment concerned, at the end of each of which the principal in respect of the debentures or instruments concerned or in respect of the relevant interest in the debentures or instruments concerned, as the case may be, is outstanding and the arrangements are in place;
  - Y means the total number of days during the basis period of the borrower for the year of assessment concerned, at the end of each of which the principal in respect of the debentures or instruments concerned or in respect of the relevant interest in the debentures or instruments concerned, as the case may be, is outstanding; and
  - Z means the total amount of sums referred to in paragraph (c) or (d), as the case may be, which, but for this subsection and subsections (2A), (2B) and (2CA), would have been deductible under subsection (1) (a) for the year of assessment concerned.  
*(Added 12 of 2004 s. 6. Amended 12 of 2016 s. 8)*

- (2CA) Where the condition for the application of subsection (1)(a) is satisfied under subsection (2)(g), the application of subsection (1)(a) is nevertheless qualified by subsection (2CB) if—
- (a) at any time during the basis period of the borrower for the year of assessment concerned, arrangements are in place, whether between the borrower and the lender or otherwise, by which any sum payable by way of interest on the money borrowed or on any part of the money borrowed is payable, whether directly or through any interposed person, to a related person; and
  - (b) the related person is, in respect of the sum—
    - (i) neither subject to profits tax in Hong Kong, nor subject to a similar tax in any territory outside Hong Kong; or

- (ii) subject to profits tax in Hong Kong, or subject to a similar tax in a territory outside Hong Kong, but no rate at which the person is subject to such tax is equal to or higher than the reference rate.

**Note—**

See subsection (2I) for elaboration on how a person is regarded as subject to a tax at a certain rate and the meanings of *similar tax*, *reference rate* and *related person*. (*Added 12 of 2016 s. 8*)

- (2CB) For the purposes of subsection (2CA), the amount of the deduction that, but for subsections (2A), (2B), (2C) and (2CA), would have been allowed under subsection (1)(a) for the year of assessment concerned in respect of sums payable by the borrower by way of interest on the money borrowed or on the relevant part of the money borrowed, as the case may be, is to be reduced by an amount calculated in accordance with the following formula—

$$\frac{A}{B} \times C$$

- where:
- A means the total number of days during the basis period of the borrower for the year of assessment concerned, at the end of each of which the principal in respect of the money borrowed or in respect of the relevant part of the money borrowed, as the case may be, is outstanding and the arrangements mentioned in subsection (2CA)(a) are in place;
  - B means the total number of days during the basis period of the borrower for the year of assessment concerned, at the end of each of which the principal in respect of the money borrowed or in respect of the relevant part of the money borrowed, as the case may be, is outstanding; and
  - C means the total amount of sums payable by the borrower by way of interest on the money borrowed or on the relevant part of the money borrowed, as the case may be, that, but for subsections (2A), (2B), (2C) and (2CA), would have been deductible under subsection (1)(a) for the year of assessment concerned. (*Added 12 of 2016 s. 8*)

- (2CC) Where a deduction under subsection (1)(a) is claimed, by virtue of subsection (2)(g), for a year of assessment in respect of interest payable on money borrowed by a corporation, no deduction is to be allowed in respect of the interest if the Commissioner is satisfied that the main purpose, or one of the main purposes, of the borrowing of the money is to utilize a loss to avoid, postpone or reduce any liability, whether of the corporation or another person, to profits tax under this Ordinance. (*Added 12 of 2016 s. 8*)
- (2CD) In subsection (2CC)—
- loss* (虧損)——
- (a) means a loss sustained by a related person within the meaning of subsection (2I)(d)(ii) or (iii) in a trade, profession or business, whether in Hong Kong or elsewhere; and
- (b) includes any balance of such loss. (*Added 12 of 2016 s. 8*)
- (2D) For the purposes of subsection (2A), if a deposit or loan is made by a trustee of a trust estate or a corporation controlled by such a trustee, the deposit or loan shall be deemed to have been made by each of the trustee, the corporation and the beneficiary under the trust. (*Added 12 of 2004 s. 6*)
- (2E) For the purposes of subsections (2B) and (2CA)— (*Amended 12 of 2016 s. 8*)
- (a) any reference in those subsections to any sum payable by way of interest on the money borrowed or on any part of the money borrowed, however described, shall be construed as including a reference to any sum payable by way of principal or interest in respect of any other loan, where the payment of such sum is— (*Amended 12 of 2016 s. 8*)
- (i) secured or guaranteed, whether wholly or in part and whether directly or indirectly, by any sum payable by way of principal or interest in respect of the money borrowed or in respect of any part of the money borrowed; or
- (ii) conditional, whether wholly or in part and whether directly or indirectly, on the payment of any sum payable by way of principal or interest in respect of the money borrowed or in respect of any part of the money borrowed;

- (b) if any sum payable by way of interest on the money borrowed or on any part of the money borrowed, as construed in accordance with paragraph (a), is payable, whether directly or through any interposed person, to a trustee of a trust estate or a corporation controlled by such a trustee, such sum shall be deemed to be so payable to each of the trustee, the corporation and the beneficiary under the trust; and



- (c) **excepted person** (除外人士) means—
- (i) a person who is chargeable to tax under this Ordinance in respect of any sum payable by way of interest on the money borrowed or on any part of the money borrowed, as construed in accordance with paragraph (a);
  - (ii) in the case of a person (other than the lender) who is connected with the borrower—
    - (A) a person who is entitled to any sum referred to in subparagraph (i) in the capacity of—
      - (I) a person acting as a trustee of a trust estate or holding property belonging to others pursuant to the terms of a contract, where the person is not beneficially entitled to the sum in question;
      - (II) a beneficiary of a unit trust to which section 26A(1A)(a)(i) or (ii) applies, where the sum in question is payable to a trustee of the unit trust in respect of a specified investment scheme referred to in section 26A(1A)(b); or
      - (III) a member of a retirement scheme which is either a recognized retirement scheme or a substantially similar retirement scheme established outside Hong Kong, where the Commissioner is satisfied that the latter scheme complies with the requirements of a supervisory authority within an acceptable regulatory regime;
    - (B) a public body;
    - (C) a body corporate, where the Government owns beneficially more than half of the issued share capital of that body corporate for the time being; or (*Amended 28 of 2012 ss. 912 & 920*)
    - (D) a financial institution or an overseas financial institution. (*Added 12 of 2004 s. 6*)
- (2F) For the purposes of subsection (2C)—

- (a) any reference in that subsection to any sum payable by way of interest on the debentures or instruments concerned or on any interest in the debentures or instruments concerned, however described, shall be construed as including a reference to any sum payable by way of principal or interest in respect of any other loan, where the payment of such sum is—
  - (i) secured or guaranteed, whether wholly or in part and whether directly or indirectly, by any sum payable by way of principal or interest in respect of the debentures or instruments concerned or in respect of any interest in the debentures or instruments concerned; or
  - (ii) conditional, whether wholly or in part and whether directly or indirectly, on the payment of any sum payable by way of principal or interest in respect of the debentures or instruments concerned or in respect of any interest in the debentures or instruments concerned;
- (b) if any sum payable by way of interest on the debentures or instruments concerned or on any interest in the debentures or instruments concerned, as construed in accordance with paragraph (a), is payable, whether directly or through any interposed person, to a trustee of a trust estate or a corporation controlled by such a trustee, such sum shall be deemed to be so payable to each of the trustee, the corporation and the beneficiary under the trust; and

- (c) **excepted person** (除外人士) means—
- (i) a person who is chargeable to tax under this Ordinance in respect of any sum payable by way of interest on the debentures or instruments concerned or on any interest in the debentures or instruments concerned, as construed in accordance with paragraph (a);
  - (ii) in the case of a person who is connected with the borrower—
    - (A) a person who is entitled to any sum referred to in subparagraph (i) in the capacity of—
      - (I) a person acting as a trustee of a trust estate or holding property belonging to others pursuant to the terms of a contract, where the person is not beneficially entitled to the sum in question;
      - (II) a beneficiary of a unit trust to which section 26A(1A)(a)(i) or (ii) applies, where the sum in question is payable to a trustee of the unit trust in respect of a specified investment scheme referred to in section 26A(1A)(b); or
      - (III) a member of a retirement scheme which is either a recognized retirement scheme or a substantially similar retirement scheme established outside Hong Kong, where the Commissioner is satisfied that the latter scheme complies with the requirements of a supervisory authority within an acceptable regulatory regime;
    - (B) a public body;
    - (C) a body corporate, where the Government owns beneficially more than half of the issued share capital of that body corporate for the time being; or (*Amended 28 of 2012 ss. 912 & 920*)
    - (D) a financial institution or an overseas financial institution. (*Added 12 of 2004 s. 6*)

- (2G) Subsection (2C) shall not apply where under the relevant arrangements, the relevant sum payable by way of interest on the debentures or instruments concerned or on any interest in the debentures or instruments concerned is payable to a market maker who, in the ordinary course of conduct of his trade, profession or business in respect of market making, holds such debentures or instruments or such interest for the purpose of providing liquidity thereof. (*Added 12 of 2004 s. 6*)
- (2H) In subsection (2G), **market maker** (市場莊家) means a person who—
- (a) is licensed or registered for dealing in securities under the Securities and Futures Ordinance (Cap. 571) or authorized to do so by a regulatory authority in a major financial centre outside Hong Kong recognized by the Commissioner for the purposes of subsection (2)(f)(ii) (A);
  - (b) in the ordinary course of conduct of his trade, profession or business in respect of market making holds himself out as being willing to buy and sell securities for his own account and on a regular basis; and
  - (c) is actively involved in market making in securities issued by a wide range of unrelated institutions. (*Added 12 of 2004 s. 6*)
- (2I) For the purposes of this subsection and subsections (2)(g) and (2CA)—
- (a) a person is, in respect of an interest or a sum, subject to a tax at a certain rate in a territory if the Commissioner is satisfied that—
    - (i) for a similar tax in a territory outside Hong Kong as mentioned in subsections (2)(g)(ii) and (2CA)(b)(i) and (ii)—tax of that nature has been paid or will be paid, whether by deduction or otherwise, at that rate by that person in respect of the interest or sum concerned in that territory as required by the laws of that territory; or
    - (ii) for profits tax in Hong Kong as mentioned in subsection (2CA)(b)(i) and (ii)—profits tax under this Ordinance has been paid or will be paid at that rate by that person in respect of the sum concerned in Hong Kong;
  - (b) **similar tax** (類似稅項) means a tax that is of substantially the same nature as profits tax under this Ordinance;

- (c) **reference rate** (參考稅率) means—
- (i) the rate specified in Schedule 8 for the year of assessment concerned; or
  - (ii) if section 14D(1) applies in respect of the borrower for the year of assessment concerned, the rate applicable under that section; and
- (d) **related person** (有關連人士) means—
- (i) the borrower;
  - (ii) a person (other than the lender) who is connected with the borrower; or
  - (iii) a person (other than the borrower) who is connected with the lender. (*Added 12 of 2016 s. 8*)
- (2J) Subsection (1)(c) and (ca) does not apply in relation to any tax paid in a DTA territory (as defined by section 48A) by a Hong Kong resident person (as defined by that section) in respect of the profits referred to in that subsection. (*Replaced 18 of 2021 s. 14*)
- (3) In this section— (*Amended 12 of 2004 s. 6*)
- associate** (相聯者), in relation to a person, means—
- (a) where the person is a natural person—
    - (i) a relative of the person;
    - (ii) a partner of the person and any relative of that partner;
    - (iii) a partnership in which the person is a partner;
    - (iv) any corporation controlled by the person, by a partner of the person or by a partnership in which the person is a partner;
    - (v) any director or principal officer of any such corporation as is referred to in subparagraph (iv);
  - (b) where the person is a corporation—
    - (i) any associated corporation;
    - (ii) any person who controls the corporation and any partner of such person, and, where either such person is a natural person, any relative of such person;
    - (iii) any director or principal officer of that corporation or of any associated corporation and any relative of any such director or officer;

- (iv) any partner of the corporation and, where such partner is a natural person, any relative of such partner;
- (c) where the person is a partnership—
  - (i) any partner of the partnership and where such partner is a partnership any partner of that partnership, any partner with the partnership in any other partnership and where such partner is a partnership any partner of that partnership and where any partner of, or with, or in any of the partnerships mentioned in this subparagraph is a natural person, any relative of such partner;
  - (ii) any corporation controlled by the partnership or by any partner thereof or, where such a partner is a natural person, any relative of such partner;
  - (iii) any corporation of which any partner is a director or principal officer;
  - (iv) any director or principal officer of a corporation referred to in subparagraph (ii);

***associated corporation*** (相聯法團), in relation to a person, means

- 
- (a) a corporation over which the person has control;
- (b) if the person is a corporation—
  - (i) a corporation which has control over the person; or
  - (ii) a corporation which is under the control of the same person as is the first-mentioned person;

***beneficiary under the trust*** (信託的受益人) means any person who benefits or is capable (whether by the exercise of a power of appointment or otherwise) of benefiting under a trust estate, either directly or through any interposed person, or who is able or might reasonably be expected to be able, whether directly or indirectly, to control the activities of the trust estate or the application of its corpus or income;

***controlled entity*** (受控制實體) has the meaning given by section 50A; (*Added 6 of 2019 s. 4*)

***export credit business*** (出口信貸業務), in relation to a jurisdiction, means the business of supporting and developing international trade by providing financing support to exporters or investors of that jurisdiction for export or investment activities outside that jurisdiction; (*Added 6 of 2019 s. 4*)

***governmental entity*** (政府實體), in relation to a jurisdiction, means

- (a) the government of the jurisdiction;
- (b) the political subdivision of the jurisdiction, including a state, a province, a county and a municipality of the jurisdiction;
- (c) a wholly owned agency or instrumentality of the jurisdiction, or of any entity mentioned in paragraph (a) or (b); or
- (d) an integral part or controlled entity of the jurisdiction;  
(*Added 6 of 2019 s. 4*)

**integral part** (組成部分) has the meaning given by section 50A;  
(*Added 6 of 2019 s. 4*)

**intra-group financing business** (集團內部融資業務), in relation to a corporation, means the business of the borrowing of money from and lending of money to its associated corporations;  
(*Added 12 of 2016 s. 8*)

**non-Hong Kong associated corporation** (非香港相聯法團) means an associated corporation that does not carry on any trade, profession or business in Hong Kong; (*Added 12 of 2016 s. 8*)

**overseas export credit agency** (海外出口信貸機構) means an organization that is owned by, or was established and is operated by, a governmental entity of a jurisdiction outside Hong Kong for the purposes of carrying on export credit business; (*Added 6 of 2019 s. 4*)

**overseas financial institution** (海外財務機構)—

- (a) means—
  - (i) a person carrying on the business of banking or deposit-taking outside Hong Kong; or
  - (ii) an overseas export credit agency; but
- (b) excludes a person or organization that the Commissioner has, under subsection (4), determined is not recognized as an overseas financial institution; (*Replaced 6 of 2019 s. 4*)

**principal officer** (主要職員) means—

- (a) a person employed by a corporation who, either alone or jointly with one or more other persons, is responsible under the immediate authority of the directors for the conduct of the business of the corporation; or
- (b) a person so employed who, under the immediate authority of a director of the corporation or a person to whom paragraph (a) applies, exercises managerial functions in respect of the corporation;

**relative** (親屬) means the spouse, parent, child, brother or sister of the relevant person, and, in deducing such a relationship, an adopted child shall be deemed to be a child both of the natural parents and the adopting parent and a step child to be the child of both the natural parents and of any step parent; (*Replaced 63 of 1997 s. 2. Amended 18 of 2021 s. 14*)

**specified tax** (指明稅項) means tax imposed by a territory outside Hong Kong on a person that is—

- (a) of substantially the same nature as tax imposed on the person under this Part;
- (b) charged on a certain percentage of income received or receivable by the person from that territory without deduction for the outgoings and expenses (whether or not they were incurred in the production of the relevant income) when computing the amount of tax charged to the person in that territory; and
- (c) not in respect of profits of the person chargeable to tax because of section 15(1)(f), (g), (i), (ia), (ib), (j), (k), (l), (la) or (lb). (*Added 18 of 2021 s. 14*)

(3A) In this section—

- (a) a corporation shall be regarded as being controlled by a person if the person has the power to secure—
  - (i) by means of the holding of shares or the possession of voting power in or in relation to that or any other corporation; or
  - (ii) by virtue of any power conferred by the articles of association or any other document regulating that or any other corporation,

that the affairs of the first-mentioned corporation are conducted in accordance with his wishes; and

- (b) a person (other than a corporation) shall be regarded as being controlled by another person if the first-mentioned person is accustomed or under an obligation, whether express or implied, and whether or not enforceable or intended to be enforceable by legal proceedings, to act, in relation to his investment or business affairs, in accordance with the directions, instructions or wishes of that other person. (*Added 12 of 2004 s. 6*)

(3B) In this section, a person is regarded as being connected with a borrower if the person is— (*Amended 12 of 2016 s. 8*)

- (a) an associated corporation of the borrower; or (*Amended 12 of 2016 s. 8*)



- (b) a person (other than a corporation)—
  - (i) who controls the borrower;
  - (ii) who is controlled by the borrower; or
  - (iii) who is under the control of the same person as is the borrower. (*Added 12 of 2004 s. 6*)
- (3C) In this section, a person is regarded as being connected with a lender if the person is—
  - (a) an associated corporation of the lender; or
  - (b) a person (other than a corporation)—
    - (i) who controls the lender;
    - (ii) who is controlled by the lender; or
    - (iii) who is under the control of the same person as is the lender. (*Added 12 of 2016 s. 8*)
- (3D) To avoid doubt, if a person is, in the production of profits, granted a right to use a ship under a funding lease as defined by section 14O(1)—
  - (a) for the purposes of subsection (1)(a), the payments of finance charges or interest by the person for the right to use the ship are to be regarded as sums payable by the person by way of interest on money borrowed by the person (*specified loan*) for the purpose of producing the profits; and
  - (b) for the purposes of subsection (2)(e)(i)(A), the specified loan is to be regarded as money borrowed wholly and exclusively to finance capital expenditure incurred by the person on the provision of the ship. (*Added 5 of 2020 s. 8*)
- (3E) To avoid doubt, a reference to a reduced tax rate in this section includes a tax rate of 0%. (*Added 5 of 2020 s. 8*)
- (4) The Commissioner may, for the purposes of this section, determine that any person or organization is not recognized as an overseas financial institution if the Commissioner is of the opinion that—
  - (a) in the case of a person carrying on the business of banking or deposit-taking outside Hong Kong—the business is not adequately supervised by a supervisory authority; or
  - (b) in the case of an organization that is an overseas export credit agency—the organization’s export credit business is not adequately monitored or regulated by the governmental entity by which the organization—

- (i) is owned; or
  - (ii) was established and is operated. *(Replaced 6 of 2019 s. 4)*
- (4A) Sections 21 and 22 of Schedule 17A (specified alternative bond scheme and its tax treatment) provide for modifications to subsection (2)(f). *(Added 10 of 2013 s. 8)*
- (5) The amendments to this section effected by the Inland Revenue (Amendment) Ordinance 1984 (36 of 1984) shall not have the effect of disallowing any deduction under subsection (1)(a) which could lawfully have been made immediately prior to the coming into force of that Ordinance where the deduction is in respect of sums payable prior to 1 April 1984. *(Added 36 of 1984 s. 4. Amended 7 of 1986 s. 4)*
- (5A) The amendments made to this section by section 6(a), (b), (c), (d), (e) and (f) of the Inland Revenue (Amendment) Ordinance 2004 (12 of 2004) (***the Amendment Ordinance***) do not apply to sums described in subsection (1)(a) which were incurred—
  - (a) before the commencement# of the Amendment Ordinance;
  - (b) under a transaction which was the subject of an application for advance clearance made to the Commissioner before 1 April 1998, and the Commissioner has before the commencement# of the Amendment Ordinance expressed the opinion that the transaction would not fall within the terms of section 61A; or
  - (c) under an arrangement which was the subject of an application made to the Commissioner under section 88A, and the Commissioner has before the commencement# of the Amendment Ordinance made a ruling under that section that the arrangement would not fall within the terms of section 61A. *(Added 12 of 2004 s. 6)*
- (5B) The amendment made to subsection (1)(g) by the Inland Revenue (Amendment) (No. 5) Ordinance 2018 (24 of 2018) applies only in relation to a year of assessment beginning on or after 1 April 2018. *(Added 24 of 2018 s. 4)*
- (5C) The amendments made to this section by the Inland Revenue (Amendment) (Miscellaneous Provisions) Ordinance 2021 (18 of 2021) apply only in relation to a year of assessment beginning on or after 1 April 2021. *(Added 18 of 2021 s. 14)*

- (6) The Chief Executive in Council may, by notice in the Gazette, amend Schedule 3. (*Added 17 of 1989 s. 5. Amended 12 of 1999 s. 3*)
- (7) The Secretary for Financial Services and the Treasury may by order published in the Gazette amend the definition of **reference rate** in subsection (2I)(c). (*Added 12 of 2016 s. 8*)  
(*Replaced 28 of 1964 s. 7. Amended 35 of 1965 s. 9; 12 of 2004 s. 6; E.R. 1 of 2012*)

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Editorial Note:

\* The amendment made by Ord. No. 31 of 1998 to section 16(1)(ga) applies in relation to the year of assessment commencing on 1 April 2000 and to all subsequent years of assessment. (31 of 1998 s. 2(2); L.N. 175 of 2000)

# Commencement date: 25 June 2004.

## 50. Tax credits

- (1) This section has effect if, under double taxation arrangements, tax payable in respect of any income in the DTA territory concerned is to be allowed as a credit against tax payable in respect of that income in Hong Kong. (*Replaced 27 of 2018 s. 7*)
- (1A) In this section—
- (a) **foreign tax** (外地稅款) means—
- (i) any tax—
- (A) that is payable in respect of any income in a DTA territory; and
- (B) that is, under the double taxation arrangements concerned, to be allowed as a credit against tax payable in respect of that income in Hong Kong; or
- (ii) any tax that would have been payable under the laws of a DTA territory but for relief—
- (A) given under the laws of the territory with a view to promoting investment or industrial, commercial, economic, scientific, educational or other development in the territory; and
- (B) provided for in the double taxation arrangements concerned;
- (b) **tax** (稅款), in relation to Hong Kong, means tax chargeable under this Ordinance; and

- (c) *income* (收入), in relation to a DTA territory, includes profits and gains within the meaning of the double taxation arrangements concerned. (*Added 27 of 2018 s. 7*)
- (1B) For the purposes of this section, *foreign tax* within the meaning of subsection (1A)(a)(ii) is treated as having been payable under the laws of the DTA territory concerned. (*Added 27 of 2018 s. 7*)
- (2) The amount of the tax chargeable in respect of the income shall be reduced by the amount of the credit:  
Provided that credit shall not be allowed against tax for any year of assessment unless the person entitled to the income is a Hong Kong resident person for that year. (*Amended 7 of 1986 s. 12; 27 of 2018 s. 7*)
- (3) The credit shall not exceed the amount which would be produced by computing the amount of the income in accordance with the provisions of this Ordinance and then charging it to tax at a rate ascertained by dividing the tax chargeable (before allowance of credit under any double taxation arrangements) on the total income of the person entitled to the income by the amount of his total income. (*Amended 27 of 2018 s. 7*)
- (4) Without prejudice to the provisions of subsection (3), the total credit to be allowed to a person for any year of assessment for foreign tax under all double taxation arrangements shall not exceed the total tax payable by him for that year of assessment. (*Amended 17 of 1989 s. 13; 27 of 2018 s. 7*)
- (5) In computing the amount of the income—
- (a) no deduction shall be allowed in respect of foreign tax (whether in respect of the same or any other income);
- (b) where the tax chargeable depends on the amount received in Hong Kong, the said amount shall be increased by the appropriate amount of the foreign tax in respect of the income; (*Amended 7 of 1986 s. 12*)
- (c) where the income includes a dividend and under the arrangements foreign tax not chargeable directly or by deduction in respect of dividend is to be taken into account in considering whether any, and if so what, credit is to be given against tax in respect of the dividend the amount of the income shall be increased by the amount of the foreign tax not so chargeable which falls to be taken into account in computing the amount of the credit,

but notwithstanding anything in the preceding provisions of this subsection a deduction shall be allowed of any amount by which the foreign tax in respect of the income exceeds the credit therefor.

- (6) Subsection (5)(a) and (b) (but not the remainder thereof) shall apply to the computation of total income for the purposes of determining the rate mentioned in subsection (3), and shall apply thereto in relation to all income in the case of which credit falls to be given for foreign tax under double taxation arrangements for the time being in force. (*Amended 27 of 2018 s. 7*)
- (7) Where—
- (a) the arrangements provide, in relation to dividends of some classes, but not in relation to dividends of other classes, that foreign tax not chargeable directly or by deduction in respect of dividends is to be taken into account in considering whether any, and if so what, credit is to be given against tax in respect of the dividends; and
- (b) a dividend is paid which is not of a class in relation to which the arrangements so provide,
- then, if the dividend is paid to a company which controls, directly or indirectly not less than one-half of the voting power in the company paying the dividend, credit shall be allowed as if the dividend were a dividend of a class in relation to which the arrangements so provide.
- (8) Credit shall not be allowed under the arrangements against tax chargeable in respect of the income of any person for any year of assessment if he elects that credits shall not be allowed in the case of his income for that year.
- (9) A claim for an allowance by way of credit may only be made before—
- (a) the end of 6 years after the end of the year of assessment; or
- (b) the end of 6 months after the date on which an assessment is made imposing liability or additional liability to tax in respect of the income on which foreign tax has been assessed,
- whichever is the later. (*Replaced 27 of 2018 s. 7*)

(9A) If a person makes a claim under subsection (9) for an allowance by way of credit and an assessor refuses to allow a credit pursuant to the claim, the assessor must give the person a written notice of the refusal and the person has the same rights of objection and appeal under Part 11 as if the notice were a notice of assessment. *(Added 27 of 2018 s. 7)*

(10) *(Repealed 27 of 2018 s. 7)*

### **51C. Business records to be kept**

(1) Subject to subsection (2), every person carrying on a trade, profession or business in Hong Kong shall keep sufficient records in the English or Chinese language of his income and expenditure to enable the assessable profits of such trade, profession or business to be readily ascertained and shall retain such records for a period of not less than 7 years after the completion of the transactions, acts or operations to which they relate. *(Amended 7 of 1986 s. 12)*

(2) Subsection (1) shall not require the preservation of any records

—  
(a) which the Commissioner has specified need not be preserved; or

(b) of a corporation which has been dissolved.

(3) For the purposes of this section, *records* (紀錄) includes—

(a) books of account (whether kept in a legible form, or in a non-legible form by means of a computer or otherwise) recording receipts and payments, or income and expenditure; and

(b) vouchers, bank statements, invoices, receipts, and such other documents as are necessary to verify the entries in the books of account referred to in paragraph (a). *(Added 48 of 1995 s. 10)*

(4) Without limiting the generality of subsection (3), the records required to be kept and retained pursuant to subsection (1) in respect of any trade, profession or business carried on during any year of assessment by any person, include—

(a) a record of the assets and liabilities of the person in relation to that trade, profession or business;

(b) a record of all entries from day to day of all sums of money received and expended by the person in relation to that trade, profession or business and the matters in respect of which the receipt and expenditure take place;

- (c) where that trade, profession or business involves dealing in goods—
    - (i) a record of all goods purchased, and of all goods sold in the carrying on of that trade, profession or business (except those sold in the course of cash retail trading customarily conducted in a trade, profession or business of the kind of which that trade, profession or business is one) showing the goods, and the sellers and buyers in sufficient detail to enable the Commissioner to readily verify the quantities and values of the goods and the identities of the sellers and buyers; and all invoices relating thereto; and
    - (ii) statements (including quantities and values) of trading stock held by the person—
      - (A) at the end of each year of assessment; or
      - (B) where the Commissioner is satisfied that the accounts of such trade, profession or business are made up to a day other than 31 March, on that day in the year of assessment,
        - and all records of stocktakings from which any such statement of trading stock has been prepared; and
  - (d) where that trade, profession or business involves the provision of services, records of the services provided in sufficient detail to enable the Commissioner to readily verify the entries referred to in paragraph (b). *(Added 48 of 1995 s. 10)*
- (5) The following provisions provide for modifications to this section—
- (a) section 10 of Schedule 16D (eligible carried interest and its tax treatment);
  - (b) section 25 of Schedule 17A (specified alternative bond scheme and its tax treatment). *(Replaced 9 of 2021 s. 9)*  
*(Added 26 of 1969 s. 28)*

**63C. Amount of provisional salaries tax\***

(1) Subject to subsections (2) and (3), provisional salaries tax in respect of any year of assessment shall be payable at the rates specified in Schedule 2 for that year of assessment by reference to the amount of the net chargeable income for the preceding year of assessment adjusted, for the purposes of this section, as follows—

- (a) any loss set off under section 12A in calculating the net assessable income, or net assessable incomes, on which that net chargeable income is based, shall be added; *(Amended 71 of 1983 s. 31(a)(i))*
- (b) any loss which may be set off under section 12A in the year of assessment shall be set off against that amount:

Provided that—

- (i) *(Repealed 20 of 2018 s. 4)*
- (ii) in no case shall the amount of provisional salaries tax charged under this subsection exceed the amount which would have been chargeable had the standard rate been charged on the whole of— *(Amended 20 of 2018 s. 4)*
  - (A) the net assessable income for the preceding year of assessment as reduced by such deductions as are under Part 4A allowable to that person; or
  - (B) in the case of a husband and wife to whom section 63B(2) applies, the aggregate of their net assessable incomes for the preceding year of assessment as reduced by such deductions as are under Part 4A allowable to them. *(Replaced 43 of 1989 s. 21. Amended 31 of 1998 s. 19)*

(1A) *(Repealed 43 of 1989 s. 21)*

- (2) If a person commences to derive income from a source on a day within any year of assessment, an assessor may estimate the sum in respect of which provisional salaries tax is payable in that year and the succeeding year of assessment. *(Amended 71 of 1983 s. 31)*
- (3) If a person ceases to derive income from a source within any year of assessment an assessor may estimate the sum in respect of which provisional salaries tax is payable for that year of assessment and for the year preceding that year of assessment. *(Amended 71 of 1983 s. 31)*
- (4) If a person is liable to pay provisional salaries tax, an assessor shall, as soon as may be after the expiration of the time limited by the notice requiring that person to furnish a return under section 51(1), assess or estimate the amount of the provisional salaries tax which he is liable to pay.



- (5) Notwithstanding subsection (4), an assessor may assess or estimate the amount of provisional salaries tax which any person is liable to pay if he is of the opinion that the person is about to leave Hong Kong or that for any other reason it is expedient to do so. (*Amended 7 of 1986 s. 12*)
- (6) When an assessor has assessed or estimated the amount of provisional salaries tax which a person is liable to pay, the Commissioner shall give a notice to that person stating the amount of provisional salaries tax to be paid, and such due date for payment thereof as may be fixed by the Commissioner.
- (6A) Where in any year of assessment a notice for payment of provisional salaries tax has been given under subsection (6) and thereafter any rate specified in Schedule 2, or any allowance provided for in Part 5, for that year of assessment is amended, the amount of provisional salaries tax stated in the notice shall nevertheless be payable. (*Added 32 of 1981 s. 9. Amended 43 of 1989 s. 21*)
- (7) For the purposes of Part 12, provisional salaries tax shall be deemed to be a tax charged under the provisions of this Ordinance and a notice under subsection (6) shall be deemed to be a notice of assessment.
- (Added 8 of 1973 s. 13. Amended 7 of 1975 s. 36; E.R. 1 of 2012)*

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Editorial Note:

\* For the calculation of net chargeable income under this section in order to ascertain provisional salaries tax in respect of the year of assessment commencing from 1 April 1990, 1 April 1991, 1 April 1992, 1 April 1993, 1 April 1994, 1 April 1995, 1 April 1996, 1 April 1997, 1 April 1998, 1 April 2003, 1 April 2004, 1 April 2007 or 1 April 2008, please also see the transitional provisions contained in 30 of 1990, 42 of 1991, 34 of 1992, 28 of 1993, 37 of 1994, 48 of 1995, 24 of 1996, 42 of 1997, 31 of 1998, 24 of 2003, 10 of 2007 or 21 of 2008 respectively.

### **63H. Amount of provisional profits tax**

- (1) Subject to subsections (2), (3) and (4), provisional profits tax in respect of any year of assessment shall be payable by reference to the amount of assessable profits for the year preceding the year of assessment, but after the set off of any loss available for set off in the year of assessment under section 19 or 19C. (*Amended 56 of 1993 s. 25; 13 of 2018 s. 6*)
- (1A) For a person other than a corporation, the tax is to be charged on the assessable profits of the person—
- (a) for any year of assessment commencing before 1 April 2018—at the standard rate; or

- (b) for any year of assessment commencing on or after 1 April 2018—in accordance with section 2 of Schedule 8A. *(Replaced 13 of 2018 s. 6)*
- (1B) For a corporation, the tax is to be charged, subject to subsections (1C) and (1D), on the assessable profits of the corporation—
- (a) for any year of assessment commencing before 1 April 2018—at the rate specified in Schedule 8; or
  - (b) for any year of assessment commencing on or after 1 April 2018—in accordance with section 2(a) of Schedule 8B. *(Added 13 of 2018 s. 6)*
- (1C) If a corporation is a partner in a partnership, in relation to any share of assessable profits of the partnership apportioned to the corporation under section 22A, the tax is to be charged—
- (a) for any year of assessment commencing before 1 April 2018—at the rate specified in Schedule 8; or
  - (b) for any year of assessment commencing on or after 1 April 2018—in accordance with section 2(b) of Schedule 8B. *(Added 13 of 2018 s. 6)*
- (1D) If a corporation has made an election under section 14B(2)(b), 14D(5)(b), 14H(4)(b), 14J(5)(b), 14P(4)(b), 14T(5)(b), 14ZD(7)(b), 14ZM(7)(b) or 14ZV(7)(b) in respect of a portion of its assessable profits, then, in relation to the rest of its assessable profits, the tax is to be charged at the rate specified in Schedule 8. *(Added 13 of 2018 s. 6. Amended 5 of 2020 s. 14; 15 of 2020 s. 14; 10 of 2022 s. 7)*
- (2) In calculating any assessable profits for a year preceding a year of assessment for the purposes of computing provisional profits tax under subsection (1), there shall be disregarded any loss available for set off in that year.
- (2A) Also, in calculating any assessable profits for the year preceding a year of assessment—
- (a) for the purposes of computing provisional profits tax under subsection (1), the reference in section 16AA(1) to “the basis period for any year of assessment” is taken to be a reference to the basis period for the year preceding the year of assessment; and
  - (b) for the purposes of computing provisional profits tax under subsection (1) in respect of the year of assessment (*relevant year of assessment*), the reference in section 16AA(2)(b) to “that year of assessment” is taken to be a reference to the relevant year of assessment. *(Added 20 of 2018 s. 7)*

- (3) Where the amount of assessable profits of a person for the year preceding the year of assessment was calculated on a basis period of more or less than 1 year, an assessor may estimate the sum in respect of which such person is liable to pay provisional profits tax in that year of assessment.
- (4) If a person commences to carry on a trade, profession or business in Hong Kong on a day within a year of assessment commencing on or after 1 April 1974, an assessor may estimate the sum in respect of which such person is liable to pay provisional profits tax in that year and the succeeding year of assessment. *(Amended 7 of 1986 s. 12)*
- (5) If a person is liable to pay provisional profits tax, an assessor shall, as soon as may be after the expiration of the time limited by the notice requiring that person to furnish a return under section 51(1), assess or estimate the amount of provisional profits tax which he is liable to pay.
- (6) Notwithstanding subsection (5), an assessor may assess or estimate the amount of provisional profits tax which any person is liable to pay if he is of the opinion that the person is about to leave Hong Kong or that for any other reason it is expedient to do so. *(Amended 7 of 1986 s. 12)*
- (7) When an assessor has assessed or estimated the amount of provisional profits tax which a person is liable to pay, the Commissioner shall give a notice to that person stating the amount of provisional profits tax to be paid, and such due date for payment thereof as may be fixed by the Commissioner.
- (7A) Where in any year of assessment a notice for payment of provisional profits tax has been given under subsection (7) and thereafter the rate of provisional tax for that year of assessment is amended, the amount of provisional profits tax stated in the notice shall nevertheless be payable. *(Added 32 of 1981 s. 10)*
- (8) For the purposes of Part 12, provisional profits tax shall be deemed to be a tax charged under this Ordinance and a notice under subsection (7) shall be deemed to be a notice of assessment.

*(Added 7 of 1975 s. 40. Amended E.R. 1 of 2012)*

### **63M. Amount of provisional property tax**

- (1) Provisional property tax in respect of any year of assessment shall be payable at the standard rate on the net assessable value of land or buildings or land and buildings for the year preceding the year of assessment.

- (2) Where the amount of assessable value of land or buildings or land and buildings for the year preceding the year of assessment was calculated in respect of a period of less than one year, an assessor may estimate the assessable value in respect of which provisional property tax is payable.
- (3) Where a person becomes chargeable to property tax during a year of assessment, an assessor may estimate the assessable value in respect of which provisional property tax is payable in that year and the succeeding year of assessment.
- (4) Where a person is liable to pay provisional property tax, an assessor shall, as soon as may be after expiration of the time limited by the notice requiring that person to furnish a return under section 51(1), assess or estimate the amount of provisional property tax which he is liable to pay.
- (5) Notwithstanding subsection (4), an assessor may assess or estimate the amount of provisional property tax which any person is liable to pay if he is of the opinion that the person is about to leave Hong Kong or that for any other reason it is expedient to do so.
- (6) When an assessor has assessed or estimated the amount of provisional property tax which a person is liable to pay, the Commissioner shall give a notice to that person stating the amount of provisional property tax to be paid, and such due date for payment thereof as may be fixed by the Commissioner.
- (7) Where in any year of assessment a notice for payment of provisional property tax has been given under subsection (6) and thereafter the allowance mentioned in section 5(1A) or the rate of provisional property tax for that year of assessment is amended, the amount of provisional property tax stated in the notice shall nevertheless be payable.
- (8) For the purposes of Part 12, provisional property tax shall be deemed to be a tax charged under this Ordinance and a notice under subsection (6) shall be deemed to be a notice of assessment. *(Amended 24 of 2003 s. 7)*

*(Added 8 of 1983 s. 18. Amended E.R. 1 of 2012)*

**80. Penalties for failure to make returns, making incorrect returns, etc.**

- (1) Any person who without reasonable excuse—
  - (a) fails to comply with the requirements of a notice given to him under section 51(3), 51A(1), 52(1) or (2), or 64(2); or

- (b) fails to attend in answer to a summons issued under section 64(2) or 68(6), or having attended fails to answer any questions put to him, being questions which, under section 64(2) or 68(6), as the case may be, may be put to him; or
- (c) fails to comply with the requirements of section 5(2)(c), 51(6), (7) or (8), 51D(1), 52(4), (5), (6) or (7), or 76(3), *(Amended 48 of 1995 s. 11)*

commits an offence and is liable on conviction to a fine at level 3, and the court may order the person convicted within a time specified in the order to do the act which he has failed to do. *(Replaced 35 of 1965 s. 40. Amended 26 of 1969 s. 37; 2 of 1971 s. 46; 43 of 1975 s. 6; 8 of 1983 s. 19; L.N. 411 of 1984; 17 of 1989 s. 18; 56 of 1993 s. 31; L.N. 338 of 1995; 4 of 2010 s. 13)*

- (1A) Any person who without reasonable excuse fails to comply with the requirements of section 51C commits an offence and is liable on conviction to a fine at level 6 and the court may order the person convicted within a time specified in the order to do the act which he has failed to do. *(Added 48 of 1995 s. 11. Amended 4 of 2010 s. 13)*
- (1AA) Without prejudice to the generality of the term “reasonable excuse” as it is used in subsection (1) in relation to section 52(4), (5), (6) or (7), where a person has failed to comply with the requirements of that section in the case of an individual in respect of whom that person is treated as the employer by virtue of the operation of section 9A, then it shall constitute a defence in any proceedings under this section against that person in respect of such failure if he shows that—
  - (a) he did not comply with those requirements because he relied upon a statement in writing—
    - (i) by that individual; and
    - (ii) in the form specified under subsection (1AC); and
  - (b) it was reasonable for him to rely upon that statement. *(Added 54 of 1995 s. 3)*
- (1AB) A person who knowingly or recklessly makes a statement of the kind referred to in subsection (1AA)(a) which in a material respect is false or misleading commits an offence and is liable on conviction to a fine at level 3. *(Added 54 of 1995 s. 3. Amended 4 of 2010 s. 13)*
- (1AC) The Commissioner may, by notice in the Gazette, specify a form for the purposes of subsection (1AA)(a). *(Added 54 of 1995 s. 3)*

- (1AD) For the avoidance of doubt, it is hereby declared that a form specified under subsection (1AC) is not subsidiary legislation. *(Added 54 of 1995 s. 3)*
- (2) Any person who without reasonable excuse—
- (a) makes, or causes or allows to be made on the person's behalf, an incorrect return by omitting or understating anything in respect of which he is required by this Ordinance to make a return, either on his behalf or on behalf of another person; *(Amended 1 of 2010 s. 7; 18 of 2021 s. 11)*
  - (b) makes an incorrect statement in connection with a claim for any deduction or allowance under this Ordinance;
  - (c) gives any incorrect information in relation to any matter or thing affecting his own liability (or the liability of any other person) to tax; *(Amended 1 of 2010 s. 7)*
  - (ca) fails to comply with section 26M(3)(a); *(Added 31 of 2018 s. 11)*
  - (cb) fails to comply with section 26Q(3)(a); *(Added 7 of 2019 s. 6)*
  - (d) fails to comply with the requirements of a notice given to him under section 51(1); or *(Amended 18 of 2021 s. 18)*
  - (e) fails to comply with section 51(2),  
commits an offence and is liable on conviction to a fine at level 3 and a further fine of treble the undercharged amount. *(Replaced 43 of 1975 s. 6. Amended L.N. 411 of 1984; 43 of 1989 s. 27; L.N. 338 of 1995; 4 of 2010 s. 13; 27 of 2018 s. 20)*
- (2AA) For the purposes of subsection (2)(a), (b), (c) and (d), engaging a service provider (as defined by section 51AAD(8)) under section 51AAD(1) does not in itself constitute a reasonable excuse. *(Added 18 of 2021 s. 11)*
- (2A) In the case of an offence under subsection (2)(d), the court may order the person convicted to comply with the requirements of the notice given to him under section 51(1) within such time as may be specified in the order. *(Added 43 of 1975 s. 6. Amended 43 of 1989 s. 27; 18 of 2021 s. 18)*
- (2B) Any person who does not comply with an order of the court under subsection (1) or (2A) or under section 51(4B)(b) commits an offence and is liable on conviction to a fine at level 4. *(Added 43 of 1975 s. 6. Amended L.N. 338 of 1995; 4 of 2010 s. 13)*

- (2C) Any person who does not comply with an order of the court under subsection (1A) commits an offence and is liable on conviction to a fine at level 6. *(Added 48 of 1995 s. 11. Amended 4 of 2010 s. 13)*
- (2D) Any person who without reasonable excuse gives any incorrect information in relation to any matter or thing affecting the person's own liability (or the liability of any other person) to any tax of a territory outside Hong Kong commits an offence if—
- (a) arrangements having effect under section 49(1A) are made with the government of that territory; and
  - (b) that tax is the subject of a provision of the arrangements that requires disclosure of information concerning tax of that territory,
- and is liable to a fine at level 3. *(Added 1 of 2010 s. 7)*
- (2E) A person commits an offence if the person, in making a self-certification that is required to be collected under Schedule 17D by a reporting financial institution—
- (a) makes a statement that is misleading, false or incorrect in a material particular; and
  - (b) knows, or is reckless as to whether, the statement is misleading, false or incorrect in a material particular. *(Added 22 of 2016 s. 9)*
- (2F) A person who commits an offence under subsection (2E) is liable on conviction to a fine at level 3. *(Added 22 of 2016 s. 9)*
- (2G) A person commits an offence—
- (a) if the person, without reasonable excuse, fails to comply with section 50AA(5);
  - (b) if the person, without reasonable excuse, fails to comply with a requirement of a notice given to the person under section 50AAB(2); or
  - (c) if—
    - (i) the person, without reasonable excuse—
      - (A) makes an incorrect statement, or provides incorrect information, in connection with any mutual agreement procedure or arbitration referred to in section 50AAB; or
      - (B) omits anything from a statement or information made or provided in connection with the procedure or arbitration; and

- (ii) the statement or information referred to in subparagraph (i)(A), or the thing referred to in subparagraph (i)(B), is material to the case or issue to which the procedure or arbitration relates. *(Added 27 of 2018 s. 20)*
- (2H) A person who commits an offence under subsection (2G)(a) is liable on conviction to—
  - (a) a fine at level 3; and
  - (b) a further fine of the undercharged amount. *(Added 27 of 2018 s. 20)*
- (2I) A person who commits an offence under subsection (2G)(b) is liable on conviction to a fine at level 3, and the court may order the person to comply, within a time specified in the order, with the requirements of the notice given to the person under section 50AAB(2). *(Added 27 of 2018 s. 20)*
- (2J) If a person fails to comply with an order of the court under subsection (2I), the person commits an offence and is liable on conviction to a fine at level 4. *(Added 27 of 2018 s. 20)*
- (2K) A person who commits an offence under subsection (2G)(c) is liable on conviction to—
  - (a) a fine at level 3; and
  - (b) a further fine of treble the undercharged amount. *(Added 27 of 2018 s. 20)*
- (2L) A person commits an offence—
  - (a) if the person, without reasonable excuse, fails to comply with a requirement under section 50AAM(11), 50AAN(3) or 50AAO(3);
  - (b) if—
    - (i) the person, without reasonable excuse, makes an incorrect statement or provides incorrect information in connection with the following claim or application, or omits anything from a statement made or information provided in connection with the following claim or application—
      - (A) the person’s claim for relief under section 50AAM, 50AAN or 50AAO; or
      - (B) the person’s application for an advance pricing arrangement under section 50AAP(1); and



- (ii) the statement or information that is incorrect, or thing that is omitted, is material to the claim or application;
  - (c) if the person, without reasonable excuse, fails to comply with a requirement under section 50AAS;
  - (d) if—
    - (i) the person either—
      - (A) without reasonable excuse and in purported compliance with a requirement under section 50AAS, provides incorrect information in relation to an advance pricing arrangement; or
      - (B) without reasonable excuse, omits anything from information provided, in relation to an advance pricing arrangement, in purported compliance with the requirement; and
    - (ii) the information referred to in subparagraph (i)(A), or the thing referred to in subparagraph (i)(B), is material to the arrangement;
  - (e) if the person, without reasonable excuse, fails to comply with a requirement of section 50AAT; or
  - (f) if the person, without reasonable excuse, fails to comply with the requirement of a notice given to the person under section 3 of Schedule 17H. (*Added 27 of 2018 s. 20*)
- (2M) A person who commits an offence under subsection (2L)(a), (b), (c) or (d) is liable on conviction to—
- (a) a fine at level 3; and
  - (b) a further fine of the undercharged amount. (*Added 27 of 2018 s. 20*)
- (2N) A person who commits an offence under subsection (2L)(e) is liable on conviction to a fine at level 5, and the court may order the person to do, within a time specified in the order, the act that the person has failed to do. (*Added 27 of 2018 s. 20*)
- (2O) If a person fails to comply with an order of the court under subsection (2N), the person commits an offence and is liable on conviction to a fine at level 6. (*Added 27 of 2018 s. 20*)
- (2P) A person who commits an offence under subsection (2L)(f) is liable on conviction to a fine at level 3. (*Added 27 of 2018 s. 20*)

- (2Q) A person commits an offence if the person, without reasonable excuse, fails to comply with a requirement of section 58C. *(Added 27 of 2018 s. 20)*
- (2R) A person who commits an offence under subsection (2Q) is liable on conviction to a fine at level 5, and the court may order the person to do, within a time specified in the order, the act that the person has failed to do. *(Added 27 of 2018 s. 20)*
- (2S) If a person fails to comply with an order of the court under subsection (2R), the person commits an offence and is liable on conviction to a fine at level 6. *(Added 27 of 2018 s. 20)*
- (2T) A person commits an offence if the person, without reasonable excuse, fails to comply with a requirement under section 10(2) of Schedule 16D. *(Added 9 of 2021 s. 10)*
- (2U) A person who commits an offence under subsection (2T) is liable on conviction to a fine at level 3, and the court may order the person to do, within a time specified in the order, the act that the person has failed to do. *(Added 9 of 2021 s. 10)*
- (2V) If a person fails to comply with an order of the court under subsection (2U), the person commits an offence and is liable on conviction to a fine at level 4. *(Added 9 of 2021 s. 10)*
- (3) No person shall be liable to any penalty under this section unless the complaint concerning such offence was made in the year of assessment in respect of or during which the offence was committed or within 6 years after the expiration thereof. *(Amended 49 of 1956 s. 61)*
- (4) Any person who aids, abets or incites another person to commit an offence under this section shall be deemed to have committed the same offence and to be liable to the same penalty. *(Added 49 of 1956 s. 61)*
- (5) The Commissioner may compound any offence under this section and may before judgment stay or compound any proceedings thereunder. *(Amended 49 of 1956 s. 61)*
- (6) The following provisions provide for modifications to this section—
- (a) section 10 of Schedule 16D (eligible carried interest and its tax treatment);
  - (b) sections 25 and 26 of Schedule 17A (specified alternative bond scheme and its tax treatment). *(Replaced 9 of 2021 s. 10)*
- (7) In this section—
- undercharged amount*** (少徵稅款)—

- (a) for an offence that relates to any incorrect return, statement or information or an omission from any statement or information—means the amount of tax that —
  - (i) has been undercharged as a result of the incorrect return, statement or information or omission; or
  - (ii) would have been so undercharged if the return, statement or information had been accepted as correct or the omission had not been detected;
- (b) for an offence that relates to a failure to comply with a provision of this Ordinance or with a notice under the provision—means the amount of tax that has been undercharged as a result of the failure, or would have been so undercharged if the failure had not been detected; or
- (c) for any other offence—means the amount of tax that has been undercharged as a result of the offence, or would have been so undercharged had the offence not been detected. (*Added 27 of 2018 s. 20*)

**82A. Additional tax in certain cases**

- (1) Any person who without reasonable excuse—
  - (a) makes, or causes or allows to be made on the person’s behalf, an incorrect return by omitting or understating anything in respect of which he is required by this Ordinance to make a return, either on his behalf or on behalf of another person; or (*Amended 1 of 2010 s. 8; 18 of 2021 s. 13*)
  - (b) makes an incorrect statement in connection with a claim for any deduction or allowance under this Ordinance; or
  - (c) gives any incorrect information in relation to any matter or thing affecting his own liability (or the liability of any other person) to tax; or (*Amended 1 of 2010 s. 8*)
  - (ca) fails to comply with section 26M(3)(a); or (*Added 31 of 2018 s. 12*)
  - (cb) fails to comply with section 26Q(3)(a); or (*Added 7 of 2019 s. 7*)
  - (d) fails to comply with the requirements of a notice given to him under section 51(1); or (*Amended 18 of 2021 s. 19*)
  - (e) fails to comply with section 51(2),
 shall, if no prosecution under section 80(2) or 82(1) has been instituted in respect of the same facts, be liable to be assessed

under this section to additional tax of an amount not exceeding treble the undercharged amount. (*Amended 43 of 1975 s. 8; 43 of 1989 s. 28; 27 of 2018 s. 23*)

(1AA) For the purposes of subsection (1)(a), (b), (c) and (d), engaging a service provider (as defined by section 51AAD(8)) under section 51AAD(1) does not in itself constitute a reasonable excuse. (*Added 18 of 2021 s. 13*)

(1A) If—

(a) a person, without reasonable excuse, fails to comply with section 50AA(5); and

(b) no prosecution for an offence under section 80 has been instituted in respect of the same facts,

the person is liable to be assessed under this section to additional tax of an amount not exceeding the undercharged amount. (*Added 27 of 2018 s. 23*)

(1B) If—

(a) a person, without reasonable excuse—

(i) makes an incorrect statement, or provides incorrect information, in connection with any mutual agreement procedure or arbitration referred to in section 50AAB; or

(ii) omits anything from a statement or information made or provided in connection with the procedure or arbitration;

(b) the statement or information referred to in paragraph (a) (i), or the thing referred to in paragraph (a)(ii), is material to the case or issue to which the procedure or arbitration relates; and

(c) no prosecution for an offence under section 80 or 82 has been instituted in respect of the same facts,

the person is liable to be assessed under this section to additional tax of an amount not exceeding treble the undercharged amount. (*Added 27 of 2018 s. 23*)

(1C) Subsection (1D) applies if—

(a) an assessment or additional assessment made on a person under section 50AAF(5) or 50AAK(9) has become final and conclusive under section 70 (the assessment or additional assessment is referred to as the ***relevant assessment***); and

- (b) the amount of the person's income as assessed under section 50AAF(5) or 50AAK(9) to which the relevant assessment relates (*the person's assessed income*) is larger than the amount of the person's income as stated in the person's tax return. (*Added 27 of 2018 s. 23*)
- (1D) The person is liable to be assessed to additional tax under this section of an amount not exceeding the difference between—
- (a) the amount of tax assessed on the basis of the amount of the person's assessed income; and
  - (b) the amount of tax that would have been assessed if the amount of the person's income as stated in the person's tax return had been accepted for the purpose of assessment. (*Added 27 of 2018 s. 23*)
- (1E) Subsection (1F) applies if—
- (a) an assessment made on a person for a year of assessment (*subject year*) has become final and conclusive under section 70 and the assessment has taken into account the person's loss for an earlier year of assessment (*year of loss*) as computed under section 50AAF(5) or 50AAK(9) (*the person's computed loss*); and
  - (b) the amount of the person's computed loss is smaller than the amount of the person's loss as stated in the person's tax return for the year of loss. (*Added 27 of 2018 s. 23*)
- (1F) The person is liable to be assessed to additional tax under this section for the subject year of an amount not exceeding the difference between—
- (a) the amount of tax assessed taking into account the amount of the person's computed loss; and
  - (b) the amount of tax that would have been assessed if the amount of the person's loss as stated in the person's tax return for the year of loss had been accepted for the purpose of assessment. (*Added 27 of 2018 s. 23*)
- (1G) A person is not liable to be assessed to additional tax under subsection (1D) or (1F) if the person proves that the person has made reasonable efforts to determine the arm's length amount under section 50AAF(1) or 50AAK(2). (*Added 27 of 2018 s. 23*)
- (1H) If—
- (a) any of the following applies—
    - (i) a person, without reasonable excuse, fails to comply with a requirement under section 50AAM(11), 50AAN(3) or 50AAO(3);

- (ii) both—
    - (A) a person, without reasonable excuse, makes an incorrect statement or provides incorrect information in connection with the following claim or application, or omits anything from a statement made or information provided in connection with the following claim or application—
      - (I) the person’s claim for relief under section 50AAM, 50AAN or 50AAO; or
      - (II) the person’s application for an advance pricing arrangement under section 50AAP(1); and
    - (B) the statement or information that is incorrect, or thing that is omitted, is material to the claim or application;
  - (iii) a person, without reasonable excuse, fails to comply with a requirement under section 50AAS;
  - (iv) both—
    - (A) a person either—
      - (I) without reasonable excuse and in purported compliance with a requirement under section 50AAS, provides incorrect information in relation to an advance pricing arrangement; or
      - (II) without reasonable excuse, omits anything from information provided, in relation to an advance pricing arrangement, in purported compliance with the requirement; and
    - (B) the information referred to in sub-subparagraph (A)(I), or the thing referred to in sub-subparagraph (A)(II), is material to the arrangement; and
  - (b) no prosecution for an offence under section 80 or 82 has been instituted in respect of the same facts,
- the person is liable to be assessed under this section to additional tax of an amount not exceeding the undercharged amount. (*Added 27 of 2018 s. 23*)

- (2) Additional tax shall be payable in addition to any amount of tax payable under an assessment, or an additional assessment under section 60.
- (3) An assessment of additional tax may be made only by the Commissioner personally or a deputy commissioner personally (each is referred to as the *specified authority*).  
(Amended 48 of 1995 s. 12; 27 of 2018 s. 23)
- (4) Before making an assessment of additional tax, the specified authority must—
  - (a) give notice to the person that the specified authority proposes to assess additional tax and the notice must—
    - (i) inform the person of the following—
      - (A) for additional tax to be assessed under subsection (1)—the alleged incorrect return, incorrect statement or incorrect information, the alleged failure to comply with section 26M(3)(a) or 26Q(3)(a), the alleged failure to comply with a requirement of the notice given to the person under section 51(1) or the alleged failure to comply with section 51(2);  
(Amended 31 of 2018 s. 12; 7 of 2019 s. 7; 18 of 2021 s. 19)
      - (B) for additional tax to be assessed under subsection (1A)—the alleged failure to comply with section 50AA(5);
      - (C) for additional tax to be assessed under subsection (1B)—the alleged incorrect statement, incorrect information or omission from any statement or information;
      - (D) for additional tax to be assessed under subsection (1D) or (1F)—the assessment or additional assessment made or computation of loss issued or revised under section 50AAF(5) or 50AAK(9);
      - (E) for additional tax to be assessed under subsection (1H)—the alleged failure to comply with a requirement under section 50AAM(11), 50AAN(3), 50AAO(3) or 50AAS or the alleged incorrect statement, incorrect information or omission from any statement or information;

- (ii) include a statement that, with regard to the proposed assessment on the person of additional tax, the person has the right—
  - (A) to submit written representations to the specified authority; and
  - (B) for additional tax to be assessed under subsection (1D) or (1F)—to submit to the specified authority written representations and evidence for the purposes of subsection (1G); and
- (iii) specify the date, which must not be earlier than 21 days from the date of service of the notice, by which representations and evidence that the person may wish to submit under subparagraph (ii) must be received by the specified authority; and
- (b) consider and take into account any representations and evidence that the specified authority may receive under paragraph (a). *(Replaced 27 of 2018 s. 23)*
- (4A) Despite subsection (4), if the specified authority is of the opinion that the person the authority proposes to assess to additional tax under this section is about to leave Hong Kong, the authority may assess the person to additional tax under this section without giving the notice otherwise required to be given under subsection (4)(a). *(Replaced 27 of 2018 s. 23)*
- (5) Notice of intention to assess additional tax and notice of an assessment to additional tax shall be given in the same manner as is provided in section 58(2) in respect of a notice of assessment under section 62.
- (6) Where a person who is liable to be assessed to additional tax has died, an assessment to additional tax may be made on his executor, and the additional tax shall be recovered as a debt due from and payable out of the deceased person's estate.
- (7) A person who has been assessed to additional tax under this section is not liable to be charged on the same facts with an offence under section 80 or 82. *(Amended 27 of 2018 s. 23)*
- (8) Section 26 of Schedule 17A (specified alternative bond scheme and its tax treatment) provides for modifications to this section. *(Added 10 of 2013 s. 16)*
- (9) In this section—
 

***undercharged amount*** (少徵稅款)—



- (a) for additional tax assessed because of any incorrect return, statement or information or an omission from any statement or information—means the amount of tax that —
  - (i) has been undercharged as a result of the incorrect return, statement or information or omission; or
  - (ii) would have been so undercharged if the return, statement or information had been accepted as correct or the omission had not been detected; or
- (b) for additional tax assessed because of a failure to comply with a provision of this Ordinance or with a notice under the provision—means the amount of tax that has been undercharged as a result of the failure, or would have been so undercharged if the failure had not been detected. (*Added 27 of 2018 s. 23*)

*(Added 26 of 1969 s. 38)*

## **89. Transitional provisions**

- (1) (*Repealed 12 of 2004 s. 20*)
- (2) In relation to amendments made by the Inland Revenue (Amendment) (No. 2) Ordinance 1993 (52 of 1993)—
  - (a) it is declared that the amendments shall be without prejudice to the provisions of Part 14. (*Amended 4 of 2010 s. 17*)
  - (b) (*Repealed 4 of 2010 s. 17*)
- (3) The transitional provisions of Schedule 9 shall have effect in relation to recognized occupational retirement schemes approved under section 87A prior to the repeal of that section by the Inland Revenue (Amendment) (No. 5) Ordinance 1993 (76 of 1993). (*Added 76 of 1993 s. 10*)
- (4) The transitional provisions of Schedule 12 shall have effect in relation to a person liable to pay provisional salaries tax in respect of the year of assessment 2001/02. (*Added 29 of 2001 s. 2*)
- (5) Schedule 14 has effect in relation to a person liable to pay provisional salaries tax in respect of the year of assessment 2005/06. (*Added 8 of 2005 s. 6*)
- (6) Schedule 21 has effect in relation to the amendments made by the Inland Revenue (Amendment) Ordinance 2011 (4 of 2011). (*Added 4 of 2011 s. 5*)

- (7) Schedule 22 has effect in relation to a person liable to pay provisional salaries tax in respect of the year of assessment commencing on 1 April 2011. *(Added 9 of 2011 s. 3)*
- (8) Schedule 24 sets out transitional provisions that have effect for the purposes of the Inland Revenue (Amendment) (No. 3) Ordinance 2011 (21 of 2011). *(Added 21 of 2011 s. 8)*
- (9) Schedule 25 has effect in relation to the following persons—
  - (a) a person liable to pay provisional salaries tax in respect of the year of assessment commencing on 1 April 2012 or the year of assessment commencing on 1 April 2013;
  - (b) a person liable to pay provisional profits tax in respect of the year of assessment commencing on 1 April 2012 or the year of assessment commencing on 1 April 2013. *(Added 21 of 2012 s. 5)*
- (10) Schedule 27 has effect in relation to a person liable to pay provisional salaries tax in respect of the year of assessment commencing on 1 April 2013. *(Added 5 of 2013 s. 3)*
- (11) Schedule 29 sets out transitional provisions that have effect for the purposes of amendments to this Ordinance made by the Inland Revenue and Stamp Duty Legislation (Alternative Bond Schemes) (Amendment) Ordinance 2013 (10 of 2013). *(Added 10 of 2013 s. 17)*
- (12) Schedule 30 has effect in relation to the following persons—
  - (a) a person liable to pay provisional salaries tax in respect of the year of assessment commencing on 1 April 2014 or the year of assessment commencing on 1 April 2015;
  - (b) a person liable to pay provisional profits tax in respect of the year of assessment commencing on 1 April 2014 or the year of assessment commencing on 1 April 2015. *(Added 3 of 2014 s. 8)*
- (13) Schedule 31 has effect in relation to a person liable to pay provisional salaries tax in respect of the year of assessment commencing on 1 April 2014. *(Added 10 of 2014 s. 3)*
- (14) Schedule 33 has effect in relation to a person liable to pay provisional salaries tax in respect of the year of assessment commencing on 1 April 2015. *(Added 10 of 2015 s. 3)*
- (15) Schedule 35 sets out transitional provisions relating to appeals against decisions of the Board of Review made before the commencement date of the Inland Revenue (Amendment) (No. 3) Ordinance 2015 (17 of 2015). *(Added 17 of 2015 s. 12)*

- (16) Schedule 36 sets out transitional provisions that have effect for the purposes of amendments to this Ordinance made by the Inland Revenue (Amendment) (No. 2) Ordinance 2016 (12 of 2016). *(Added 12 of 2016 s. 17)*
- (17) Schedule 37 has effect in relation to a person liable to pay provisional salaries tax in respect of the year of assessment commencing on 1 April 2016. *(Added 8 of 2016 s. 3)*
- (18) Schedule 39 has effect in relation to a person liable to pay provisional salaries tax in respect of the year of assessment commencing on 1 April 2017. *(Added 3 of 2017 s. 4)*
- (19) Schedule 41 sets out transitional provisions that have effect for the purposes of amendments to this Ordinance made by the Inland Revenue (Amendment) (No. 3) Ordinance 2017 (9 of 2017). *(Added 9 of 2017 s. 14)*
- (20) Schedule 42 has effect in relation to a person liable to pay provisional profits tax in respect of the year of assessment commencing on 1 April 2018. *(Added 13 of 2018 s. 8)*
- (21) Schedule 44 sets out transitional provisions that have effect for the purposes of amendments to this Ordinance made by the Inland Revenue (Amendment) (No. 6) Ordinance 2018 (27 of 2018). *(Added 27 of 2018 s. 34)*
- (22) Schedule 46 has effect in relation to a person liable to pay provisional salaries tax in respect of the year of assessment commencing on 1 April 2019. *(Added 31 of 2018 s. 13)*
- (23) Schedule 47 sets out transitional provisions that have effect for the purposes of amendments to this Ordinance made by the Inland Revenue (Amendment) Ordinance 2019 (4 of 2019). *(Added 4 of 2019 s. 12)*
- (24) Schedule 48 sets out transitional provisions that have effect for the purposes of amendments to this Ordinance made by the Inland Revenue (Amendment) (No. 2) Ordinance 2019 (6 of 2019). *(Added 6 of 2019 s. 12)*
- (25) Schedule 50 sets out transitional provisions that have effect for the purposes of the amendments to this Ordinance made by the Inland Revenue (Amendment) (Profits Tax Concessions for Insurance-related Businesses) Ordinance 2020 (15 of 2020). *(Added 15 of 2020 s. 15)*
- (26) Schedule 51 sets out transitional provisions that have effect for the purposes of amendments to this Ordinance made by the Inland Revenue (Amendment) (Ship Leasing Tax Concessions) Ordinance 2020 (5 of 2020). *(Added 5 of 2020 s. 15)*

- (27) Schedule 52 has effect in relation to a person liable to pay provisional salaries tax in respect of the year of assessment commencing on 1 April 2022. (*Added 7 of 2022 s. 6*)
- (28) Schedule 53 sets out a transitional provision that has effect for the purposes of amendments to this Ordinance made by the Inland Revenue (Amendment) (Tax Concessions for Certain Shipping-related Activities) Ordinance 2022 (10 of 2022). (*Added 10 of 2022 s. 8*)
- (*Amended E.R. 1 of 2012*)

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## Schedule 17G

[ss. 50AAC & 58B & Sch.  
44]

### **Meaning of *Permanent Establishment* in Hong Kong**

*(Schedule 17G added 27 of 2018 s. 10)*

#### **Part 1**

#### **Preliminary**

##### **1. Interpretation**

- (1) An expression used in this Schedule, and defined or otherwise explained in Part 8AA, has the same meaning as in that Part.
- (2) In this Schedule—  
*company* (公司) means any body corporate or any entity that is treated as a body corporate for tax purposes.

##### **2. Interpretation: *closely related, closely related person and closely related enterprise***

- (1) For the purposes of this Schedule, a person (*person A*) is closely related to another person (*person B*) if, based on all the relevant facts and circumstances—
- (a) person A has control of person B;
  - (b) person B has control of person A; or
  - (c) person A and person B are both under the control of the same other person or enterprise.
- (2) Also, a person (*person A*) is taken to be closely related to another person (*person B*) if—

- (a) person A possesses directly or indirectly more than the specified interest in person B;
  - (b) person B possesses directly or indirectly more than the specified interest in person A; or
  - (c) another person possesses directly or indirectly more than the specified interest in each of person A and person B.
- (3) In subsection (2)—
- specified interest*** (指明權益), in relation to a person, means—
- (a) 50% of the beneficial interest in the person; or
  - (b) if the person is a company, 50% of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company.
- (4) A reference to closely related person or closely related enterprise is to be read accordingly.

## **Part 2**

### **Permanent Establishment of DTA Territory Resident Person**

#### **3. Permanent establishment of DTA territory resident person**

Whether a DTA territory resident person has a permanent establishment in Hong Kong is to be determined in accordance with the relevant provisions under the double taxation arrangements concerned.

## **Part 3**

### **Permanent Establishment of Non-DTA Territory Resident Person**

#### **4. Permanent establishment constituted by fixed place of business**

- (1) Subject to sections 5, 6 and 7 of this Schedule, an enterprise that is a non-DTA territory resident person has a permanent establishment in Hong Kong if it has a fixed place of business in Hong Kong through which the business of the enterprise is wholly or partly carried on.
- (2) For the purpose of subsection (1), a fixed place of business includes, but is not limited to—
  - (a) a place of management;

- (b) a branch;
  - (c) an office;
  - (d) a factory;
  - (e) a workshop; and
  - (f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.
- (3) For the purpose of subsection (1), a building site or construction or installation project is a permanent establishment of an enterprise (*subject enterprise*) only if—
- (a) the subject enterprise has carried on activities at the site or project for a period of more than 12 months; or
  - (b) all of the following apply—
    - (i) the subject enterprise has carried on activities at the site or project for a period that exceeds, or 2 or more periods that in the aggregate exceed, 30 days;
    - (ii) connected activities have been carried on at the site or project by one or more closely related enterprises of the subject enterprise for one or more different periods that each exceeds 30 days;
    - (iii) all the periods referred to in subparagraphs (i) and (ii) in the aggregate exceed 12 months.
- (4) In determining whether different activities are connected for the purposes of subsection (3)(b)(ii), regard is to be had to the facts and circumstances of the case, including in particular—
- (a) whether the contracts covering the different activities were concluded with the same person or closely related persons;
  - (b) whether the conclusion of additional contracts with a person is a logical consequence of a previous contract concluded with the person or closely related persons;
  - (c) whether the activities would have been covered by a single contract absent tax planning considerations;
  - (d) whether the nature of the work involved under the different contracts is the same or similar; and
  - (e) whether the same employees are performing the activities under the different contracts.

**5. Preparatory or auxiliary activities not constitute permanent establishment**

- (1) This section applies subject to section 6 of this Schedule.

- (2) If the 1st or 2nd set of conditions are met in relation to an enterprise, the enterprise is not regarded under section 4(1) of this Schedule as having a permanent establishment in Hong Kong even if it has a fixed place of business in Hong Kong through which the business of the enterprise is carried on.
- (3) The 1st set of conditions are—
- (a) the activity carried on for the enterprise through the place consists solely of one of the following—
    - (i) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandize belonging to the enterprise;
    - (ii) the maintenance of a stock of goods or merchandize belonging to the enterprise solely for the purpose of storage, display or delivery;
    - (iii) the maintenance of a stock of goods or merchandize belonging to the enterprise solely for the purpose of processing by another enterprise;
    - (iv) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandize, or collecting information, for the enterprise;
    - (v) the maintenance of a fixed place of business solely for the purpose of carrying on any other activity for the enterprise; and
  - (b) in relation to the business of the enterprise as a whole, the activity is of a preparatory or auxiliary character.
- (4) The 2nd set of conditions are—
- (a) the activities carried on for the enterprise through the place consist solely of any combination of the activities mentioned in subsection (3)(a)(i), (ii), (iii), (iv) and (v); and
  - (b) the overall activity of the place resulting from the combination of the activities is of a preparatory or auxiliary character.

**6. Section 5(2) of this Schedule does not apply if certain activities constitute complementary functions**

Section 5(2) of this Schedule does not apply to an enterprise (*subject enterprise*) with a fixed place of business (*place A*) in Hong Kong if—

- (a) either or both of the following apply—

- (i) business activities at place A are carried on by a closely related enterprise of the subject enterprise;
- (ii) business activities are carried on at another place (**place B**) in Hong Kong by the subject enterprise or its closely related enterprise;
- (b) the business activities carried on at place A by the subject enterprise and those referred to in paragraph (a) constitute complementary functions that are part of a cohesive business operation; and
- (c) any one or more of the following apply—
  - (i) place A would have constituted a permanent establishment for the subject enterprise but for section 5(2) of this Schedule;
  - (ii) place A constitutes a permanent establishment for the closely related enterprise;
  - (iii) place B constitutes a permanent establishment for the subject enterprise or the closely related enterprise;
  - (iv) the overall activity resulting from the combination of the following is not of a preparatory or auxiliary character—
    - (A) the business activities carried on at place A by the subject enterprise;
    - (B) business activities referred to in paragraph (a).

## 7. **Permanent establishment constituted by agent's activities**

- (1) Despite section 4(1) of this Schedule, an enterprise (***the enterprise***) that is a non-DTA territory resident person is taken to have a permanent establishment in Hong Kong in respect of any activities (***the activities***) that a person (***the person***) undertakes for the enterprise if—
  - (a) the person is acting in Hong Kong on behalf of the enterprise and in doing so—
    - (i) habitually concludes contracts; or
    - (ii) habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise; and
  - (b) the contracts are—
    - (i) in the name of the enterprise;



- (ii) for the transfer of the ownership of, or for the granting of the right to use, property owned by the enterprise or that the enterprise has the right to use; or
  - (iii) for the provision of services by the enterprise.
- (2) Subsection (1) does not apply if the activities of the person are limited to activities that, if exercised through a fixed place of business, would not make the fixed place of business a permanent establishment under section 4(1) of this Schedule, having regard to sections 5 and 6 of this Schedule.
- (3) Subsection (1) does not apply if the person—
  - (a) carries on business in Hong Kong as an independent agent; and
  - (b) acts for the enterprise in the ordinary course of that business.
- (4) A person is not an independent agent for the purposes of subsection (3) if the person acts exclusively, or almost exclusively, on behalf of one or more enterprises that are closely related to the person.

**8. Company not constituted permanent establishment of another company**

- (1) Even if—
  - (a) a company (*company A*) controls or is controlled by another company (*company B*);
  - (b) company A is resident for tax purposes in a non-DTA territory;
  - (c) company B—
    - (i) is resident for tax purposes in Hong Kong; or
    - (ii) carries on business in Hong Kong (whether through a permanent establishment or otherwise),

these matters do not of themselves constitute either company a permanent establishment of the other.
- (2) This section does not affect the operation of the other provisions of this Schedule.

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**Schedule 45**

[ss. 4, 15, 16, 16B, 37, 37A,  
39B, 40, 40AO & 40AT &  
Sch. 17J]

## Deduction of R&D Expenditures

(Schedule 45 added 29 of 2018 s. 13)

### Part 1

#### Preliminary

##### 1. Interpretation

(1) In this Schedule—

**2018 Amendment Ordinance** (《2018年修訂條例》) means the Inland Revenue (Amendment) (No. 7) Ordinance 2018 (29 of 2018);

**amended Ordinance** (《經修訂條例》) means this Ordinance as amended by the 2018 Amendment Ordinance;

**\*commencement date** (生效日期) means the day on which the 2018 Amendment Ordinance comes into operation;

**designated local research institution** (指定本地研究機構) means a designated local research institution designated under section 19 of this Schedule;

**interim Type A expenditure** (中期甲類開支)—see section 9 of this Schedule;

**interim Type B expenditure** (中期乙類開支)—see section 11 of this Schedule;

**pre-amended Ordinance** (《原有條例》) means this Ordinance as in force immediately before the commencement date;

**qualifying expenditure related to trade, profession or business** (關乎行業、專業或業務的合資格開支)—see section 12 of this Schedule;

**qualifying R&D activity** (合資格研發活動)—see section 4 of this Schedule;

**qualifying R&D activity related to trade, profession or business** (關乎行業、專業或業務的合資格研發活動)—see section 5 of this Schedule;

**R&D activity** (研發活動)—see section 2 of this Schedule;

**R&D activity related to trade, profession or business** (關乎行業、專業或業務的研發活動)—see section 3 of this Schedule;

**R&D expenditure** (研發開支)—see section 6 of this Schedule;

*specified period* (指明期間) means the period beginning on 1 April 2018 and ending immediately before the commencement date;

*Type A expenditure* (甲類開支)—see section 8 of this Schedule;

*Type B expenditure* (乙類開支)—see section 10 of this Schedule.

(2) For the purposes of this Schedule, a reference to rights includes a share or interest in rights.

## 2. **Meaning of *R&D activity***

An R&D activity is—

- (a) an activity in the fields of natural or applied science to extend knowledge;
- (b) a systematic, investigative or experimental activity carried on for the purposes of any feasibility study or in relation to any market, business or management research;
- (c) an original and planned investigation carried on with the prospect of gaining new scientific or technical knowledge and understanding; or
- (d) the application of research findings or other knowledge to a plan or design for producing or introducing new or substantially improved materials, devices, products, processes, systems or services before they are commercially produced or used.

## 3. **Meaning of *R&D activity related to trade, profession or business***

(1) An R&D activity related to a trade, profession or business includes—

- (a) an R&D activity that may lead to or facilitate an extension, or an improvement in the technical efficiency, of the trade, profession or business; and
- (b) an R&D activity of a medical nature that is of particular relevance to the welfare of employees employed in the trade, profession or business.

(2) An R&D activity related to a class of trade, profession or business includes—

- (a) an R&D activity that may lead to or facilitate an extension, or an improvement in the technical efficiency, of the class of trade, profession or business; and
- (b) an R&D activity of a medical nature that is of particular relevance to the welfare of employees employed in the class of trade, profession or business.

## 4. **Meaning of *qualifying R&D activity***

- (1) A qualifying R&D activity is an R&D activity that—
  - (a) falls within the description in section 2(a), (c) or (d) of this Schedule; and
  - (b) is wholly undertaken and carried on in Hong Kong.
- (2) A qualifying R&D activity does not include—
  - (a) any efficiency survey, feasibility study, management study, market research or sales promotion;
  - (b) the application of any publicly available research findings or other knowledge to a plan or design, with an anticipated outcome and without any scientific or technological uncertainty;
  - (c) an activity that does not seek to directly contribute to achieving an advance in science or technology by resolving scientific or technological uncertainty; or
  - (d) any work to develop the non-scientific or non-technological aspect of a new or substantially improved material, device, product, process, system or service.

**5. Meaning of *qualifying R&D activity related to trade, profession or business***

- (1) A qualifying R&D activity related to a trade, profession or business includes—
  - (a) a qualifying R&D activity that may lead to or facilitate an extension, or an improvement in the technical efficiency, of the trade, profession or business; and
  - (b) a qualifying R&D activity of a medical nature that is of particular relevance to the welfare of employees employed in the trade, profession or business.
- (2) A qualifying R&D activity related to a class of trade, profession or business includes—
  - (a) a qualifying R&D activity that may lead to or facilitate an extension, or an improvement in the technical efficiency, of the class of trade, profession or business; and
  - (b) a qualifying R&D activity of a medical nature that is of particular relevance to the welfare of employees employed in the class of trade, profession or business.

**6. Meaning of *R&D expenditure***

- (1) An R&D expenditure, in relation to a trade, profession or business in respect of which a person is chargeable to tax under Part 4, is—

- (a) a payment to an R&D institution for an R&D activity related to the trade, profession or business;
  - (b) a payment to an R&D institution which has, as an object, the undertaking of an R&D activity related to the class of trade, profession or business to which the trade, profession or business belongs, where the payment is used for pursuing that object; or
  - (c) any other expenditure on an R&D activity related to the trade, profession or business, including capital expenditure except to the extent that it is expenditure on land or buildings or on alterations, additions or extensions to buildings.
- (2) A payment referred to in subsection (1)(a) or (b) does not include a payment to the R&D institution for acquiring rights generated from an R&D activity.
- (3) For the purposes of subsection (1)(a) and (b), a payment to a local institution—
- (a) that is not a university or college; and
  - (b) that is not, and never has been, a designated local research institution,
- is a payment to an R&D institution if the local institution is designated as a designated local research institution within 6 months after the date of payment.
- (4) An expenditure referred to in subsection (1)(c)—
- (a) includes an expenditure for carrying out, and providing facilities for carrying out, an R&D activity; and
  - (b) does not include an expenditure for acquiring rights generated from an R&D activity.

(5) In this section—

***R&D institution*** (研發機構) means—

- (a) a designated local research institution; or
- (b) a university or college that is not a designated local research institution.

## 7. When R&D expenditure is incurred

- (1) An R&D expenditure is incurred by a person—
- (a) for a payment referred to in section 6(1)(a) or (b) of this Schedule—at the time the payment is made by the person; or

- (b) for an expenditure referred to in section 6(1)(c) of this Schedule—at the time the expenditure is incurred by the person.
- (2) However, for a person who is about to carry on a trade, profession or business, the following R&D expenditures are treated as if they had been incurred on the first day on which the person carries on the trade, profession or business—
  - (a) a payment referred to in section 6(1)(a) or (b) of this Schedule made by the person;
  - (b) an expenditure referred to in section 6(1)(c) of this Schedule incurred by the person.

**8. Meaning of *Type A expenditure***

A Type A expenditure, in relation to a trade, profession or business in respect of which a person is chargeable to tax under Part 4, is—

- (a) for a payment made, or other expenditure incurred, on or after the commencement date—an R&D expenditure other than a Type B expenditure within the meaning of section 10(1)(a) of this Schedule; or
- (b) for a payment made, or other expenditure incurred, during the specified period—an interim Type A expenditure.

**9. Meaning of *interim Type A expenditure***

- (1) An interim Type A expenditure is a payment made during the specified period that—
  - (a) would have been deductible under section 16B(1)(a) of the pre-amended Ordinance; and
  - (b) would not be a Type B expenditure within the meaning of section 10(1)(a) of this Schedule deductible under section 16B of the amended Ordinance if, on the date of payment, that Ordinance were in force.
- (2) Also, an interim Type A expenditure is a payment that—
  - (a) is made during the specified period to a university, college, institute, association, organization or corporation (*entity*) that is, on the commencement date, a designated local research institution;
  - (b) would not have been deductible under section 16B(1)(a) of the pre-amended Ordinance; and

- (c) would be a Type A expenditure within the meaning of section 8(a) of this Schedule deductible under section 16B of the amended Ordinance if, on the date of payment, that Ordinance were in force and the entity were a designated local research institution.
- (3) Also, an interim Type A expenditure is any other expenditure (*specified expenditure*) incurred during the specified period that—
- (a) would have been deductible under section 16B(1)(b) of the pre-amended Ordinance; and
  - (b) would not be a Type B expenditure within the meaning of section 10(1)(a) of this Schedule deductible under section 16B of the amended Ordinance if, on the date on which the specified expenditure is incurred, that Ordinance were in force.

## 10. Meaning of *Type B expenditure*

- (1) A Type B expenditure, in relation to a trade, profession or business in respect of which a person is chargeable to tax under Part 4, is—
- (a) for a payment made, or other expenditure incurred, on or after the commencement date—an R&D expenditure falling within any of the following descriptions—
    - (i) a payment to a designated local research institution for a qualifying R&D activity related to the trade, profession or business;
    - (ii) a payment to a designated local research institution which has, as an object, the undertaking of a qualifying R&D activity related to the class of trade, profession or business to which the trade, profession or business belongs, where the payment is used for pursuing that object;
    - (iii) a qualifying expenditure related to the trade, profession or business; or
  - (b) for a payment made, or other expenditure incurred, during the specified period—an interim Type B expenditure.
- (2) For the purposes of subsection (1)(a)(i) and (ii), a payment to a local institution—
- (a) that is not a university or college; and
  - (b) that is not, and never has been, a designated local research institution,

is a payment to a designated local research institution if the local institution is designated as a designated local research institution within 6 months after the date of payment.

**11. Meaning of *interim Type B expenditure***

- (1) An interim Type B expenditure is a payment that—
  - (a) is made during the specified period to a university, college, institute, association, organization or corporation (*entity*) that is, on the commencement date, a designated local research institution; and
  - (b) would be a Type B expenditure within the meaning of section 10(1)(a) of this Schedule deductible under section 16B of the amended Ordinance if, on the date of payment, that Ordinance were in force and the entity were a designated local research institution.
- (2) Also, an interim Type B expenditure is any other expenditure (*specified expenditure*) incurred during the specified period that—
  - (a) would have been deductible under section 16B(1)(b) of the pre-amended Ordinance; and
  - (b) would be a Type B expenditure within the meaning of section 10(1)(a) of this Schedule deductible under section 16B of the amended Ordinance if, on the date on which the specified expenditure is incurred, that Ordinance were in force.

**12. Meaning of *qualifying expenditure related to trade, profession or business***

- (1) A qualifying expenditure related to a trade, profession or business is—
  - (a) an expenditure in relation to an employee who is engaged directly and actively in a qualifying R&D activity related to the trade, profession or business; or
  - (b) an expenditure on a consumable item that is used directly in a qualifying R&D activity related to the trade, profession or business.
- (2) In ascertaining the expenditure in relation to an employee who is only partly engaged directly and actively in a qualifying R&D activity related to the trade, profession or business, the appropriate proportion of the expenditure is to be taken into account.



- (3) In ascertaining the expenditure on a consumable item that is only partly used directly in a qualifying R&D activity related to the trade, profession or business, the appropriate proportion of the expenditure is to be taken into account.
- (4) For the purposes of this section—
- (a) a person is not engaged directly and actively in a qualifying R&D activity related to a trade, profession or business only because the person provides, in support of the activity, services such as—
    - (i) any accounting service;
    - (ii) any administrative service; or
    - (iii) any secretarial service; and
  - (b) a consumable item is not used directly in a qualifying R&D activity related to a trade, profession or business only because the item is used in providing, in support of the activity, services such as—
    - (i) any accounting service;
    - (ii) any administrative service; or
    - (iii) any secretarial service.

(5) In this section—

**consumable item** (消耗品) means any material or item, including any fuel, power and water that, when used, is consumed or transformed in such a way that it is no longer usable in its original form;

**director** (董事) means a person who is—

- (a) a director as defined by section 2(1) of the Companies Ordinance (Cap. 622) (**Cap. 622 director**);
- (b) a shadow director as defined by section 2(1) of the Companies Ordinance (Cap. 622) (**shadow director**); or
- (c) a person who has similar functions, powers and duties to a Cap. 622 director or a shadow director under the law of a place outside Hong Kong that is similar to the Companies Ordinance (Cap. 622);

**expenditure in relation to an employee** (關於僱員的開支)—

- (a) means any salary, wages or any of the following items, paid or granted (whether in cash or any other form), to or in respect of an employee in relation to the employment—
  - (i) an ordinary annual contribution to a fund duly established under a recognized occupational retirement scheme;

- (ii) an ordinary annual premium in respect of a contract of insurance under a recognized occupational retirement scheme;
  - (iii) any contributions made to a mandatory provident fund scheme at regular intervals that are either of similar or substantially similar amounts or of amounts calculated by reference to a scale or a fixed percentage of the employee's salary or other remuneration;
  - (iv) any other benefit that constitutes a cash outlay paid by the employer; and
- (b) does not include any remuneration of a director, or any item that falls within the description in paragraph (a)(i), (ii), (iii) or (iv) paid or granted (whether in cash or any other form) to or in respect of a director.

## **Part 2**

### **Deduction for R&D Expenditures**

#### **13. Total amount of deduction under section 16B**

- (1) This section applies subject to sections 14 and 15 of this Schedule.
- (2) In ascertaining the profits from a trade, profession or business in respect of which a person is chargeable to tax under Part 4 for a year of assessment, the amount allowed to be deducted under section 16B for R&D expenditures incurred by the person during the basis period for the year of assessment is the sum of—
  - (a) for Type A expenditures—subject to subsection (3), 100% of the expenditures; and
  - (b) for Type B expenditures—
    - (i) if the total amount of the expenditures exceeds \$2,000,000—\$6,000,000 plus 200% of the part of the expenditures that exceeds \$2,000,000; or
    - (ii) if the total amount of the expenditures does not exceed \$2,000,000—300% of the expenditures.
- (3) If—
  - (a) a Type A expenditure is incurred for an R&D activity carried on outside Hong Kong in relation to a trade, profession or business; and

- (b) the trade, profession or business is carried on partly in, and partly out of, Hong Kong,

the amount allowed to be deducted for the expenditure is the appropriate proportion of the expenditure that the Commissioner considers is reasonable in the circumstances.

#### **14. Expenditures that may not be deducted**

No deduction is to be allowed under section 16B for an R&D expenditure incurred on or after the commencement date by a person if—

- (a) for an R&D expenditure incurred by the person that falls within the description in section 6(1)(a) or (c) of this Schedule—
  - (i) any rights generated from the activity are not, or will not be, fully vested in the person; or
  - (ii) the activity is undertaken for another person;
- (b) the expenditure is, or is to be, met directly or indirectly by—
  - (i) the Government;
  - (ii) the government of any place outside Hong Kong;
  - (iii) any public or local authority in Hong Kong or elsewhere; or
  - (iv) another person; or
- (c) the expenditure is incurred under an arrangement the main purpose, or one of the main purposes, of which is to enable the person to obtain—
  - (i) a deduction to which the person would not otherwise be entitled under section 16B; or
  - (ii) a deduction of a greater amount than the amount to which the person would otherwise be entitled under section 16B.

#### **15. No multiple deduction**

An R&D expenditure may only be deducted for one trade, profession or business.

### **Part 3**

#### **Proceeds of Sale**

- 16. Proceeds of sale of certain plant or machinery treated as trading receipts**
- (1) This section applies in relation to plant or machinery representing expenditure or expenditures of a capital nature allowed under section 16B as a deduction or deductions in ascertaining the profits from a trade, profession or business in respect of which a person is chargeable to tax under Part 4 if—
    - (a) the plant or machinery ceases to be used by the person for any R&D activity related to the trade, profession or business; and
    - (b) the plant or machinery is subsequently sold by the person, or destroyed, on or after 1 April 2018.
  - (2) The proceeds of sale of the plant or machinery must be treated as a trading receipt arising in or derived from Hong Kong of the trade, profession or business accruing—
    - (a) at the time of the sale; or
    - (b) if the sale occurs on or after the date on which the trade, profession or business is permanently discontinued—immediately before the discontinuance.
  - (3) However, subsection (2) applies to the proceeds of sale of the plant or machinery only to the extent that the proceeds—
    - (a) are not chargeable to tax under any other provision of Part 4; and
    - (b) do not exceed the total amount of deductions allowed under section 16B for expenditure or expenditures of a capital nature represented by the plant or machinery.
  - (4) If the plant or machinery is destroyed—
    - (a) the plant or machinery is, for the purposes of subsection (2), to be treated as if it had been sold immediately before its destruction; and
    - (b) any insurance moneys or other compensation of any description received by the person carrying on the trade, profession or business in respect of the destruction, and any money received by the person in respect of the remains of the plant or machinery, are to be treated as if they were the proceeds of that sale.
  - (5) For the purposes of this section, a sale occurs at the time of its completion or the time when possession of the plant or machinery is given, whichever happens earlier.

**17. Proceeds of sale of rights treated as trading receipts**

- (1) This section applies in relation to rights sold on or after 1 April 2018 where the rights were generated from one or more R&D activities for which expenditure or expenditures have been allowed under section 16B as a deduction or deductions in ascertaining the profits from a trade, profession or business in respect of which a person is chargeable to tax under Part 4.
- (2) This section applies despite the exclusion relating to the sale of capital assets in section 14.
- (3) The proceeds of sale of the rights must, to the extent that the proceeds are not chargeable to tax under any other provision of Part 4, be treated as a trading receipt arising in or derived from Hong Kong of the trade, profession or business of a specified amount accruing—
  - (a) unless paragraph (b) applies—at the time of completion of the sale; or
  - (b) if the sale is completed on or after the date on which the trade, profession or business is permanently discontinued—immediately before the discontinuance.
- (4) For the purposes of subsection (3), the specified amount is—
  - (a) if the expenditures deducted for the R&D activity or activities that generated the rights (*underlying activities*) consist of both Type A expenditure and Type B expenditure—the specified amount calculated under subsection (7);
  - (b) otherwise—the lesser of—
    - (i) the total amount of deductions allowed under section 16B for the expenditures; and
    - (ii) subject to subsection (5), the proceeds of sale.
- (5) If any relevant Type A expenditure for the underlying activities was not allowed to be deducted in full because of the operation of section 13(3) of this Schedule or section 16B(2) (as in force before the commencement date), the proceeds of sale referred to in subsection (4)(b)(ii) are to be adjusted downward.
- (6) The adjusted proceeds of sale are to bear the same ratio to the actual proceeds of sale as the ratio that the total amount of deduction or deductions allowed for all Type A expenditures for the underlying activities bears to those Type A expenditures.
- (7) The specified amount referred to in subsection (4)(a) is to be calculated in accordance with the following steps—

**Step 1**

Divide the proceeds of sale into **sale proceeds A** and **sale proceeds B** according to the ratio between—

- (a) Type A expenditures that were incurred on the underlying activities; and
- (b) Type B expenditures that were incurred on the underlying activities.

### Step 2

Calculate an **amount A** which equals the lesser of—

- (a) the total amount of deductions for Type A expenditures; and
- (b) sale proceeds A.

For the purpose of calculating **amount A**, sale proceeds A are to be adjusted downward if any relevant Type A expenditure for the underlying activities was not allowed to be deducted in full because of the operation of section 13(3) of this Schedule or section 16B(2) (as in force before the commencement date).

The adjusted amount is to bear the same ratio to sale proceeds A as the ratio that the total amount of deduction or deductions allowed for all Type A expenditures for the underlying activities bears to those Type A expenditures.

### Step 3

Calculate an **amount B** which equals the lesser of—

- (a) the total amount of deductions for Type B expenditures; and
- (b) sale proceeds B.

### Step 4

Add amount A and amount B together to get the **specified amount**.

- (8) To avoid doubt and without limiting the meaning of expenditure in this Schedule, for the purposes of subsections (1) and (4), an expenditure includes a payment.

- (9) In this section—

**proceeds of sale** (售賣得益) means the proceeds of sale that are not attributable to the sale of plant or machinery;

**Type A expenditure** (甲類開支) includes—

- (a) any payment described in section 16B(1)(a) (as in force before the commencement date) that is made before 1 April 2018; and

- (b) any expenditure described in section 16B(1)(b) (as in force before the commencement date) that is incurred before 1 April 2018.

## **Part 4**

### **Miscellaneous Matters**

#### **18. Commissioner may seek advice from Commissioner for I&T on certain matters**

- (1) This section applies if a claim, or an application under section 88A(1), is made by a person to the Commissioner in relation to a deduction under section 16B.
- (2) On receiving the claim or application, the Commissioner may seek advice from the Commissioner for I&T, or a public officer authorized by the Commissioner for I&T, in order to ascertain—
  - (a) for a claim made in relation to a deduction under section 16B—
    - (i) whether an activity constitutes an R&D activity or a qualifying R&D activity; and
    - (ii) whether an R&D expenditure was incurred by the claimant in relation to an R&D activity or a qualifying R&D activity; and
  - (b) for an application made in relation to a deduction under section 16B—
    - (i) whether an activity constitutes an R&D activity or a qualifying R&D activity;
    - (ii) whether an R&D expenditure that was incurred by the applicant was incurred in relation to an R&D activity or a qualifying R&D activity; and
    - (iii) whether an R&D expenditure to be incurred by the applicant is, if incurred, an R&D expenditure incurred in relation to an R&D activity or a qualifying R&D activity.

#### **19. Designation of local institutions as designated local research institution**

- (1) The Commissioner for I&T may designate any of the following institutions as a designated local research institution—
  - (a) any university or college located in Hong Kong;

- (b) any other local institution that undertakes qualifying R&D activities in Hong Kong.
- (2) If the Commissioner for I&T decides to designate a university, college or local institution under subsection (1), the Commissioner for I&T must, as soon as reasonably practicable, give a copy of the instrument of designation to the university, college or institution.
- (3) A designation made under subsection (1)—
  - (a) takes effect on the date specified in the instrument of designation; and
  - (b) may be revoked by the Commissioner for I&T at any time.
- (4) If the designation of a university, college or local institution is revoked under subsection (3)(b), the Commissioner for I&T must, as soon as reasonably practicable, give a copy of the instrument of revocation to the university, college or institution.
- (5) The revocation takes effect on the date specified in the instrument of revocation.
- (6) In this section—  
*local institution* (本地機構) means an institute, association, organization or corporation that is located in Hong Kong.

## **Part 5**

### **Transitional Provision for Inland Revenue (Amendment) (No. 7) Ordinance 2018**

#### **20. Transitional provision relating to section 16B**

- (1) This section applies for the purposes of ascertaining the profits from a trade, profession or business in respect of which a person is chargeable to tax under Part 4 for a year of assessment if the basis period of the person for that year of assessment includes all or any of the specified period.
- (2) Section 16B (other than section 16B(3) and (3A)), as in force before the commencement date, continues to apply in relation to—
  - (a) a payment made before 1 April 2018; and
  - (b) an expenditure incurred before 1 April 2018.



- (3) Section 16B, as in force before the commencement date, continues to apply in relation to a sale of plant or machinery, and to a sale of rights generated from one or more R&D activities, that occurred before 1 April 2018.

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Editorial Note:

\* Commencement date: 2 November 2018.

## **Economic, Financial and Civil Service Implications of the Proposal**

### Economic Implications

The proposal will demonstrate Hong Kong's commitment to supporting international efforts in combating cross-border tax evasion and preventing double non-taxation. This is particularly crucial for Hong Kong to preserve its competitiveness and reputation as an international financial and business centre, and to avoid being listed as a "non-cooperative" tax jurisdiction by the EU.

2. The legislative proposal will mainly affect shell companies set up by MNE groups in Hong Kong presumably for tax reasons. The economic impact is not expected to be significant given the shell companies by their nature do not bring fruitful economic contributions and plentiful job opportunities to Hong Kong. On the contrary, the proposal may encourage in-scope MNE groups which have a limited economic presence in Hong Kong to take certain steps to comply with the economic substance requirement (such as by employing more qualified employees and incurring more operating expenditures in Hong Kong) in order to enjoy tax exemption.

3. With regard to the proposed adoption of the nexus approach, we consider that there is very limited room and incentives for MNE groups with foreign-sourced IP income to shift their income to other jurisdictions for tax savings given that the nexus approach is an international standard widely adopted in comparable jurisdictions.

### Financial and Civil Service Implications

4. Additional resources have been provided to the Inland Revenue Department since 1 April 2022 and beyond to cope with the work arising from reinforced international tax co-operation and tax matters of large MNE groups in Hong Kong.

5. In-scope MNE groups operating in Hong Kong should have no major difficulty in meeting the economic substance requirement to enjoy tax exemption for non-IP income. While some in-scope MNEs may fail to fully comply with the nexus approach for the IP income, the resulting increase in tax revenue is not expected to be significant given the availability of double taxation relief. Overall speaking, the increase in tax revenue as a result of the implementation of the legislative proposal is not expected to be significant.