



Hong Kong Tax Updates

Amendments to the Inland Revenue Ordinance (IRO)

Inland Revenue (Amendment) (No.5) Ordinance 2018

The amendments expand profits tax deductions to capital expenditure incurred in the purchase of three types of intellectual properties and charges receipts derived from these properties.

S.15(1)(b) and s.15(1)(ba) extend the charge of Profits Tax to sums received for the use or right to use etc of layout-design (topography) of an integrated circuit, performer's right and plant variety right.

S.16(1)(g) is extended to plant variety right.

S.16EA (deduction of capital expenditure incurred in the purchase of certain intellectual properties) is extended to performer's economic right, protected layout-design (topography) right and protected plant variety right.

Inland Revenue (Amendment) (No.6) Ordinance 2018

The No. 6 Amendment Ord was enacted on 13 July 2018. It introduces new statutory regimes in respect of transfer pricing, advance pricing arrangement (APA), Country-by-Country Reporting, transfer pricing documentation and makes consequential amendments to other provisions of the IRO, such as offence and penalties. It amends provisions on double taxation reliefs and other miscellaneous areas. The part relating to double taxation relief under salaries tax has been reported in the Dec 2018 newsletter of TIHK. This Amendment Ordinance makes very substantial changes. The other salient points are set out below.



Double Taxation Relief

S.8(1A)(c)

See Dec 2018 newsletter of TIHK.

s.16(1)(c)

S.16(1)(c) grants deduction for profits tax purposes for foreign income tax paid on interest income, profits from certificate of deposits etc. Under the new law, s.16(1)(c) does not apply if the foreign tax is allowed as a tax credit under a double taxation arrangement (DTA).

Amendments to s.50 (Tax Credit)

(1) Foreign tax includes tax that would have been payable in a DTA territory but for relief given under the DTA territory to promoting investment or other purposes and provided for in the DTA concerned.

(2) A claim for tax credit may only be made before the end of 6 years after the end of the year of assessment or the end of 6 months after the date on which an assessment is made in respect of the income subject to double taxation, whichever is the later.

(3) If a claim for tax credit is refused, the assessor must give a written notice of the refusal and the taxpayer has a right of objection and appeal.

New S.50AA

The amount of any double taxation relief (under s.8(1A)(c), s.16(1)(c) and s.50) must not exceed the amount of the relief that would be granted had all foreign tax minimization steps been taken. The latter refers to all reasonable steps taken to minimize foreign tax whether under the domestic law of the foreign country or under the DTA. If after obtaining relief from double taxation, subsequently the relief becomes excessive as a result of an adjustment to the amount of foreign tax, the taxpayer must inform the Commissioner in writing within 3 months after the adjustment is made. If as a result of the adjustment to the foreign tax or HK tax payable, the relief becomes excessive or insufficient, an assessment or additional assessment or claim may be made before the end of 2 years from the time of assessments, adjustments or determinations or expiry of the time limit for making the assessment, additional assessment or claim, whichever is the later.



New s.50AAB - mutual agreement procedure (MAP)

A person may present a case for MAP under a DTA. If a solution is arrived at, whether by the Commissioner unilaterally, by agreement between Hong Kong and the DTA territory or by arbitration, the Commissioner must give effect to the solution, agreement or decision (MAP solution) by making any appropriate adjustments (other than penalties for tax offences) despite any provision in the IRO.

Transfer Pricing

New Part 8AA, Schedules 17G and 17 H.

Part 8AA applies to salaries tax, property tax and profits tax.

Computation of income or loss (s.50AAF to s.50AAK)

(1) Rule 1

Where actual provision has been made or imposed between two persons by way of a transaction or a series of transactions, the said actual provision being differed from that which would have been made between independent persons (arm's length provisions) and conferring a potential advantage in relation to Hong Kong tax on an advantaged person, the arm's length provision is to be applied in computing the Hong Kong income or loss of an advantaged person (s.50AAF). For Rule 1 to apply, the participation condition must be satisfied ie the affected person was participating in the management, control or capital of the other affected person (s.50AAG).

An assessor may give a notice to the advantaged person requiring the person to prove to the satisfaction of the assessor that the amount of the person's income or loss is the arm's length amount. If the advantaged person fails to prove the same to the assessor's satisfaction, the assessor must assess an amount as the arm's length amount.



The actual provision is not taken to confer a potential advantage in relation to HK tax on either of the affected persons if the following conditions are met (s.50AAJ(2)):

(a) Domestic nature condition

(b) either the "no actual tax difference" condition or "non-business loan condition) (s.50AAJ(6) and

(c) the actual provision does not have a tax avoidance purpose (as defined in s.50AAJ(7).

(2) Rule 2 Permanent Establishment (PE) in HK (s.50AAK)

Where a non-resident person has a PE in Hong Kong, the income or loss of that person which is attributable to the PE is computed as if the PE were a distinct and separate enterprise that engaged in the same or similar activities and dealt wholly independently with the person.

Relief consequential on Transfer Pricing Adjustment (s.50AAL to s.50AAO)

(1) Not involving foreign tax

If transfer pricing adjustment has been made on an advantaged person in respect of income or loss from relevant activities, the disadvantaged person may claim to have income or loss from the relevant activities to be computed as if the arm's length provision has been made or imposed instead of the actual provision. The claim must be made in writing within 6 years after the end of the relevant year of assessment or the end of 6 months after the date on which an assessment is made on the advantaged person or the disadvantaged person taking into account the income or loss arising from the relevant activities or the end of 6 months after the date on which a computation of loss is issued to the advantaged person or disadvantaged person whichever is the latest (s.50AAM).



(2) Involving foreign tax

If the arm's length provision is applied to the advantaged person in relation to foreign tax in a DTA territory and the disadvantaged person has income or loss arising from the relevant activities computed for HK tax purposes and a MAP arm's length provision has been determined under the DTA, the disadvantaged person may claim that the said income or loss is to be computed on the basis of the MAP arm's length provision (s.50AAN).

(3) Involving foreign tax: non- HK resident person's PE.

The non-resident HK resident may claim to have the income or loss computed for the purpose of HK tax in a way that is consistent with the MAP attribution to the PE in HK (s.50AAO).

Advanced Pricing Arrangement (APA) (s.50AAP to s.50AAW)

APA may be made with the Commissioner on how the transfer pricing provisions may be applied for a fixed period of time. If a person has disclosed in the tax return that the person has relied on the APA in preparing and providing the return, then, subject to certain provisions, the Commissioner is to apply the transfer pricing provisions in accordance with the APA for the year of assessment. The CIR may revoke, cancel or revise an APA if any condition or critical assumption has not been met or is no longer met; the person has failed to comply with obligations under the APA or the person is found to have made or provided incorrect statement or information or omitted to give material statement or information in applying for the APA. The person must retain for a period of not less than 7 years after the end of the period specified in the APA all records relied on in concluding, used in applying for or referred to in any report or information provided to the CIR under, the APA. If the APA is inconsistent with a MPA made under a DTA, the CIR must revise the APA so far as may be necessary for effect to be given to the MPA.



New Schedule 17G - Meaning of PE in HK

(1) The PE of a DTA territory resident person is to be determined by reference to the DTA.

(2) Non-DTA territory resident

(a) A non-DTA territory resident has a PE in HK if it has a fixed place of business in HK (which includes but is not limited to, a place of management, a branch, an office etc) through which the business of the enterprise is wholly or partly carried on.

(b) If the activities carried on in the fixed place of business is preparatory or auxiliary in nature, the enterprise is not regarded as having a PE in HK e.g. storage, display or delivery of goods, purchasing goods or collecting information for the enterprises. The place will be regarded as a PE if the aforesaid activities of preparatory or auxiliary character constitute complimentary functions of closely related enterprises.

(c) Dependent Agent

The enterprise is taken to have a PE in HK if it has a dependent agent which acts on its behalf in HK and habitually concludes contracts in the name of the enterprise or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise for the transfer of or granting the right to use property of the enterprise or for the provision of services by the enterprise. The activities of the dependent agent will not amount to a PE if the activities are no more than preparatory or auxiliary in nature unless they constitute complementary functions of closely related enterprises. Activities of an independent agent acting for the enterprises in the ordinary course of business will not constitute a PE. A person is not an independent agent if the person acts exclusively or almost exclusively, on behalf of one or more closely related enterprise.



New Schedule 17H - Application for APA

Schedule 17H sets out the details requirements for the application. The CIR may appoint an independent expert to inquire into and report on the application. If the CIR refuses the application, he must give the reasons thereof. Fees not exceeding \$500,000 (not including the costs of any expert or costs and reasonable expenses of the CIR) are payable to the IRD.

Other Amendments relating to Transfer Pricing

New s.15BA - Changes in Trading Stock

- (1) If trading stock is appropriated for non-trade purpose, then in calculating the profits of the trade, the open market value at the time of the appropriation is treated as receipt while the actual receipt is left out of account.
- (2) If an asset which is not trading stock becomes trading stock, the open market value at the time it becomes trading stock is taken to be the cost in calculating the profits of the trade.
- (3) If trading stock is disposed otherwise in the course of trade, the open market value at the time of disposal is treated as the receipt (not applicable if s.15C (cessation of business) applies).
- (4) If stock is acquired otherwise than in the course of trade, the open market value at the time of acquisition is treated as the cost in computing the profits of the trade (not applicable if s.15C applies).
- (5) Trading stock for the purpose of s.15BA means goods sold in the ordinary course of business or would be so sold if it is mature or the manufacture, preparation or construction is complete.



New s.15F Sums derived from intellectual property by non-HK resident associates

Where a person has made value creation contributions in HK in relation to an intellectual property and a sum is received by a non-HK resident associate for the use (whether in or outside HK) of the intellectual property, a part of the sum that is attributable to the person's value creation contributions in HK is to be regarded as a taxable receipt of the person. Value creation means contributions through performing the functions of and assuming risks or providing assets in and assuming risks relating to the development, enhancement, maintenance, protection or exploitation of the intellectual property. Intellectual property includes cinematograph or TV film, patent, design, trade mark, copyright material, performer's right, secret process or formula or other property or right of similar nature.

S.20 (liability of certain non-resident person)

S.20 is abolished.

Transfer Pricing Documentation Including Country-by-Country Report

New Part 9A (s.58B to s.58O) and Schedule 17I

Local File and Master File

The Hong Kong entity of a group must prepare, within 9 months after the end of each accounting period of the entity, a file in respect of the accounting period (**local file**) and a file in respect of the corresponding accounting period of the group (**master file**) and retains the file for a period of not less than 7 years after the end of the accounting period of the entity. This requirement does not apply to the HK entity in respect of which any 2 of the following conditions are satisfied -

- (i) the total revenue of the entity for the accounting period does not exceed \$400 million



(ii) the total value of assets at the end of the accounting period does not exceed \$300 million

(iii) the average number of employees during the accounting period does not exceed 100.

A local file of the HK entity is not required to cover:

(i) specified domestic transactions (s2 Schedule 17I);

(ii) controlled transactions (transactions between associates in a group) which do not exceed, for each type, \$44 million to \$220 million, depending on the types of transactions (s.5 Schedule 17I).

Country-by-Country Report (CbCR)

(1) A reportable group is a multinational enterprise group whose total consolidated group revenue in the immediately preceding accounting period:

(i) exceeds \$6.8 billion or

(ii) if the multinational enterprise group's ultimate parent entity (UPE) is tax resident in a foreign jurisdiction, the amount specified by the foreign jurisdiction or the amount, in the currency of the foreign jurisdiction, that is equivalent to EUR 750 million as at January 2015.

(2) A HK UPE of a reportable group must file a CbCR by the filing deadline (s.58E). A HK entity of a reportable group which is not the UPE must file a CbCR by the filing deadline (s.58F) if certain conditions are fulfilled (s.58I) e.g. the country of residence of the UPE does not require the filing of CbCR, there is no exchange of information arrangement etc.



- (3) Filing may be done by a surrogate parent entity (SPE) where a SPE is appointed by the group under s.58I(3) (SPE not resident in HK) or (4) (SPE resident in HK) as the sole substitute for the UPE to file the CbCR on behalf of the group.

The HK UPE, the SPE which is tax resident in HK or a HK entity that is required to file a CbCR under s.58F must inform the CIR in writing particulars of each of the group's HK entities and, in case the UPE is not tax resident in HK, the jurisdiction of tax residence and other particulars of the UPE and any other information relevant for determining a HK entity's obligation to file a CbCR (s.58H).

An assessor may give a written notice to an entity requiring it to file a CbCR for specified accounting period (s.58G).

A service provider may be engaged to file CbCR or to comply with the aforesaid obligations (s.58M).

The obligations of Part 9A applies to a person who acts for the a non-corporate reporting entity or is responsible for the management of the entity. In relation to a HK entity that is a PE of an enterprise, Part 9A applies to the enterprise.

If a person enters into any arrangements and the main purpose is to avoid any obligation under Part 9A, the Part has effect as if the arrangement had not been entered into (s.58O).



Prescribed Information in Master File and Local File (Schedule 17I)

Schedule 17I prescribes information to be kept in Local File and Master File.

Amendments to Penalties and Offences

New s.80(2G) to s.80(2S) are added to impose penalties for failure, without reasonable excuse, to comply with the various new obligations mentioned aforesaid, making incorrect statement or providing incorrect information in connection with a claim for double taxation relief, any MAP or arbitration, corresponding relief consequent on transfer pricing adjustment and relief or application in relation to an APA. The penalties range from a fine at level 3 to level 6 with or without a further fine of the undercharged amount or treble the undercharged amount.

New s.80G to s.80J are added to impose penalties for failure to comply, without reasonable excuse, the obligations in connection with CbCRs or files with intent to defraud, CbCR or a notice in connection with CbCR which is misleading, false or inaccurate in a material particular. The penalties are imposed on the reporting entities and service providers. A director or other officer concerned in the management of a corporation or service provider which commits the offence, is also liable if the offence was committed with the consent or connivance of the director or officer. A reporting entity or a service provider commits an offence if the entity or service provider discovers that the CbCR filed or information provided in connection with CbCR is misleading, false or inaccurate in a material particular and without reasonable excuse, fails to notify the CIR of the discovery within a reasonable time. The penalties for the aforesaid offences range from a fine at level 5 to level 6, a daily fine, with or without imprisonment for 6 months or 3 years.

Prosecution for fraud

New S.82(1AA), s.82(1AAB) and s.82(1AAC) are added, imposing penalty for, willfully, with intent to evade tax or assist any other person to evade tax, making an incorrect statement or providing incorrect information in connection with a claim for relief



consequent on transfer pricing adjustment or application for APA, a MAP or arbitration under s.50AAB.

S.82A Additional Tax

New s.82A(1A) to (1H) are added to impose penalties in the form of additional tax for failure without reasonable excuse, to comply with the various new obligations mentioned aforesaid, making incorrect statement or providing incorrect information in connection with a claim for double taxation relief, any MAP or arbitration, corresponding relief consequent on transfer pricing adjustment and relief or application in relation to an APA.

If a transfer pricing adjustment has been made and the amount of income so assessed is larger than the amount of income as stated in the taxpayer's tax return, or an assessment is made by taking into account an earlier loss as computed by IRD and the computed loss is smaller than the amount as stated in the tax return, the taxpayer is liable to additional tax. A person is not liable if the person can prove that the person has made reasonable efforts to determine the arm's length amount.

The additional tax is an amount not exceeding the undercharged amount or treble the undercharged amount depending on the nature of offences.

Amendments to Advance Ruling

The CIR will not make a ruling in regard to application of transfer pricing to computation of income or loss under s.50AAF or 50AAK (Schedule 10 s.1A).

The fees for Advance Ruling applications are revised upward.



Amendments to Profits Tax Concessions for Particular Classes of Persons

New S.26AB added. The CIR may prescribe the threshold requirement for determining whether, for the purposes of a concession condition, an activity producing the assessable profits of a corporation that fall within s.14B, 14D, 14H or 14J or exempt sums in s.23B is carried out in HK by the taxpayer.

Inland Revenue Amendment Bill (No.7) 2018

The bill was passed by the Legislative Council on 20 Feb 2019. The salient points of the amendment are reported below.

Alignment of tax treatment of Financial Instruments with accounting treatment

New as. 18G to 18L added. The amendments allow a taxpayer who prepares financial statements in accordance with the Hong Kong Financial Reporting Standard 9 (Financial Instruments) (HKFRS 9) or the International Financial Reporting Standard 9 (Financial Instruments) (IFRS 9) to elect to adopt fair value accounting for tax purposes, contrary to the decision of *Nice Cheer Investment Ltd* FACV 23/2012. The effect is that the tax-relevant amount (i.e. the profit, loss, income, expense etc for tax purposes) in respect of a financial instrument is the accounting-relevant amount (i.e. the profit, loss, income, expense etc recognized in the accounts) in respect of the instrument. The election is irrevocable and has effect for the election year and all subsequent years of assessment. Any adjustment of the profit, loss, income or expense which would have been made in respect of the preceding year had fair value accounting been adopted for tax purposes for that year must be brought into account in computing the assessable profits for the election year. An election may be revoked with the consent of the CIR if the CIR is satisfied that there are good commercial reasons for the revocation and the main or one of the main purposes of the revocation is not tax avoidance. If a person, after making the election, fails to prepare financial statements in accordance with HKFRS9 or IFRS9 for a year, the election ceases to have effect from the year and all subsequent years and every financial



instrument held by the person at the end of the basis period for the year of assessment immediately preceding the cessation year is taken to have been disposed of and reacquired, or released and reassumed, at its fair value on the first day of the basis period for the cessation year.

S.18J(4) provides that where a financial instrument is measured at fair value, the interest income, interest expense, discount or premium on debt security etc derived therefrom chargeable or allowable for tax purposes are the amount recognized in profit or loss. S.18K sets out the treatment of impairment loss in respect of a financial instrument.

S.18L sets out the treatment of:

- (i) gain or loss on equity instrument,
- (ii) gain or loss on financial liability,
- (iii) interest, discount, premium or expense recognized in respect of debt securities issued with an embedded derivative which is attributable to the embedded derivative,
- (iv) interest, discount, premium or expense recognized in respect of preference shares and
- (iv) profit, loss, income or expense of a hedging instrument.

Interest expense payable to overseas export credit agency

The definition of overseas financial institution in s.16(3) is expanded to include an overseas export credit agency which means an organisation established by a foreign government to carry on an export credit business.



Automatic Exchange of Financial Account Information (AEOI)

- (1) The various terms in the interpretation section (s.50A) are amended and new terms are added e.g. definition of entity (including a legal person, a legal arrangement and one that can establish a permanent customer relationship with a financial institution or otherwise own property), pre-existing account, reporting year, 2020-covered institution, FATF Recommendations.
- (2) New s.50L added - The CIR may issue guidelines on Part 8A-related provisions (Returns by Financial Institutions) to best secure consistency between Part 8A-related provisions and the Common Reporting Standards (CRS) (which are standards contained in the Standard for AEOI in Tax Matters published by OECD).
- (3) Amendments made to Schedules 17C, D and E.

Avoidance of Double Non-Taxation of Visiting Teacher or Researcher

If a visiting teacher or researcher derives income from services in a territory outside HK and under the DTA of that territory with HK, the income is exempt from tax in that territory, the income can be exempt from HK tax (under s.8(1A)(b)) only if the taxpayer can prove to the CIR that tax has been paid in that territory despite the exemption provision.

Dependent brother or sister allowance

The definition of brother or sister is extended to include a brother or sister of full or half blood, an adopted brother or sister, a step brother or sister and the natural child of an adoptive parent.



Hong Kong Tax Cases

Feng Hongyan v The Collector of Stamp Revenue HCAL165/2017

On 3 July 2015, the Appellant entered into a preliminary agreement to purchase 40D of a residential tower. On 6 Aug 2015, she entered into a preliminary agreement for the purchase of Flat 51A of the same residential tower. The ad valorem stamp duty ("AVD") was duly paid. On 4 Sep 2015, the Applicant and the vendor of Flat 40D entered into a cancellation agreement whereby the parties agreed to cancel the 40D agreement for sale and purchase. The Applicant applied for partial refund of the AVD paid on the purchase of 51A on the basis that within 6 months of the purchase, she had disposed of 40D. The Collector refused the application. Thereupon the Applicant applied for judicial review of the Collector's decision. The issue was whether the cancellation of the 40D agreement was a conveyance on sale within the Stamp Duty Ordinance ("SDO"). The High Court judge rejected the judicial review application. The cancellation agreement was not a conveyance. There was no transfer or vesting of any property or interest therein. Secondly there was no sale. Thirdly there was no sale to a purchaser. "Purchaser" was defined s.29A(1). The vendor under the cancellation agreement did not fall within s.29A(1). The judge rejected the argument in respect of the legislative intent of the Counsel for the Applicant, holding that there was no room to look beyond the clear words of a statute.

Chen An v Collector of Stamp Revenue DCSA 17 /2015

The Appellant migrated to Hong Kong in Feb 2007 from the Mainland. In 2014, she was eligible to become a Hong Kong permanent resident ("HKPR") On 10 Sep 2014, at 3:00 pm she duly attended an interview at the Immigration Department for a verification appointment. During the interview, an Immigration Department officer informed her that all the time-slots for identify card collection on that day had been take up. She signed up for collection on 18 Sep 2014. At

6 pm of 10 Sep 2014, she entered into a preliminary sale and purchase agreement for the purchase of a property for a consideration of HK\$15 million with the applicable stamp duty



at HK\$1,125,000 under Scale 1 of Head 1(1A) of the First Schedule of the Stamp Duty Ordinance ("SDO"). She subsequently applied for partial refund of the stamp duty on the ground that she was a HKPR at the time of purchase of the property such that the applicable scale should be Scale 2 instead of Scale 1. The Collector refused the application on that the ground that she was not a holder of a Hong Kong identity card at the time of purchase. as required by s.29A(1)(a) (all references to sections are to those of the SDO unless otherwise specified). On appeal to the District Court pursuant to s.14, The District Court judge rejected her application, holding that "hold" within s.29A(1)(a) means physical holding of a valid permanent identity card.

Reported by Mr HO Chi Ming FTIHK, CTA

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