

DECEMBER 2019 AND JUNE 2020
SUPPLEMENT

Qualification Programme

Module D

Taxation



Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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Introduction

This Supplement is to be used in conjunction with the sixth edition of the Learning Pack, and it will bring you fully up to date for developments that have occurred in the period between publication of the Learning Pack and 31 May 2019, the cut-off date for examinable contents for the December 2019 and June 2020 examinations.

The Supplement comprises a technical update on developments that will be examinable in December 2019 and June 2020 examination sessions that are not currently covered in the Learning Pack. The topics covered are listed on the contents page, and again are covered in chapter order.

In each case the text in the Supplement explains how the Learning Pack is affected by the change, for example whether the new material should be read in addition to the current material in the Learning Pack, or whether the new material should be regarded as a replacement.

Good luck with your studies!

Part A: Identified Errata

Chapter 3	Hong Kong profits tax				
Section 9.4.3 Page 245	In part (a) of the solution to Example 89, revise ss.39(B)(1) & (2) in the seventh line of the first paragraph to ss.39B(1) & (2), and s.38(B) in the first line of the second paragraph to s.38B.				
Section 9.4.8 Page 249	Under section 9.4.8 'Assets brought into business after non-business use: ss.37(2A) & 39B(6)', replace the first paragraph with the following paragraph:				
	When an asset previously acquired for private use is subsequently brought into business use, no initial allowance is granted as no capital expenditure is incurred. Annual allowance is to be computed based on the deemed cost of the asset (i.e. actual cost of the asset less notional amount of annual allowances for the period of non-business use) transferred into the respective pool.				
Solution to Example 122 Page 291	Revise the profits tax payable as follows:				
		HK\$			
	Profits tax at 16.5%	244,530			
	Less: Tax reduction (maximum)	<u>(20,000)</u>			
	Profits tax payable	<u>224,530</u>			
Example 126 Page 309	Revise the profits tax payable as follows:				
		HK\$			
	Profits tax at 15%	133,050			
	Less: Tax reduction (maximum)	<u>(20,000)</u>			
		113,050			
	Less: Property tax set off under s.25	<u>(12,000)</u>			
	Profits tax payable	<u>101,050</u>			
Answer 11 Page 384	Revise the profits tax payable as follows:				
		HK\$			
	Tax thereon at 16.5%	1,206,568			
	Less: Tax reduction (maximum)	<u>(30,000)</u>			
	Profits tax payable	<u>1,176,568</u>			
Answer 14 Page 386	Revise the profits tax payable as follows:				
		Mr Au	Mr Bill	CKL Ltd	Total
	Tax thereon at 15%	169,332	311,830		481,162
	Tax thereon at 16.5%			214,864	214,864
	Less: Tax reduction (maximum)	<u>(4,866)</u>	<u>(8,960)</u>	<u>(6,174)</u>	<u>(20,000)</u>
	Profits tax payable	<u>164,466</u>	<u>302,870</u>	<u>208,690</u>	<u>676,026</u>
Answer to exam practice questions Page 934	Revise the profits tax payable as follows:				
		HK\$			
	Tax thereon at 16.5%	630,603			
	Less: Tax reduction (maximum)	<u>(20,000)</u>			
	Profits tax payable	<u>610,603</u>			

Part B: Technical Updates

Note. All the amounts quoted in \$ in this Supplement are HK\$.

Tax tables

Pages xx and xxiv Remove '& onwards' from the caption of 'Year of assessment 2017/18 & onwards' on page xx and page xxiv.

Then, add the following new table on page xx and page xxiv:

Year of assessment 2018/19 & onwards

	Net Chargeable Income (\$)	Rate	Tax (\$)
On the First	50,000	2%	1,000
On the Next	50,000	6%	3,000
On the Next	50,000	10%	5,000
On the Next	<u>50,000</u>	14%	<u>7,000</u>
	200,000		16,000
Remainder		17%	

Then, add the following note under the above tax rate table:

For 2018/19, 75% of the final tax payable under profits tax, salaries tax and tax under personal assessment would be waived, subject to a ceiling of \$20,000 per case.

For 2017/18, 75% of the final tax payable under profits tax, salaries tax and tax under personal assessment would be waived, subject to a ceiling of \$30,000 per case.

Pages xxi and xxii

Replace the following tables on pages xxi and xxii:

Annual income levels at which salaries taxpayers enter the standard rate zone

	Year of assessment 2014/15 (\$)	Year of assessment 2015/16 (\$)	Year of assessment 2016/17 (\$)	Year of assessment 2017/18 (\$)	Year of assessment 2018/19 (\$)
Single	1,620,000	1,620,000	1,722,000	1,797,000	2,022,000
Married	2,640,000	2,640,000	2,844,000	2,919,000	3,144,000
Married + 1 child*	3,235,000	3,490,000	3,694,000	3,769,000	4,164,000
Married + 2 children*	3,830,000	4,340,000	4,544,000	4,619,000	5,184,000
Married + 3 children*	4,425,000	5,190,000	5,394,000	5,469,000	6,204,000

Including two dependent parents or grandparents aged 60 or above

	Year of assessment 2014/15 (\$)	Year of assessment 2015/16 (\$)	Year of assessment 2016/17 (\$)	Year of assessment 2017/18 (\$)	Year of assessment 2018/19 (\$)
Single	2,300,000	2,300,000	2,504,000	2,579,000	2,872,000
Married	3,320,000	3,320,000	3,626,000	3,701,000	3,994,000
Married + 1 child*	3,915,000	4,170,000	4,476,000	4,551,000	5,014,000
Married + 2 children*	4,510,000	5,020,000	5,326,000	5,401,000	6,034,000
Married + 3 children*	5,105,000	5,870,000	6,176,000	6,251,000	7,054,000

Including two dependent parents or grandparents aged 60 or above living with you

	Year of assessment 2014/15 (\$)	Year of assessment 2015/16 (\$)	Year of assessment 2016/17 (\$)	Year of assessment 2017/18 (\$)	Year of assessment 2018/19 (\$)
Single	2,980,000	2,980,000	3,286,000	3,361,000	3,722,000
Married	4,000,000	4,000,000	4,408,000	4,483,000	4,844,000
Married + 1 child*	4,595,000	4,850,000	5,258,000	5,333,000	5,864,000
Married + 2 children*	5,190,000	5,700,000	6,108,000	6,183,000	6,884,000
Married + 3 children*	5,785,000	6,550,000	6,958,000	7,033,000	7,094,000

Including one dependent parent or grandparent aged 60 or above and living with you and one disabled dependant brother or sister

	Year of assessment 2014/15 (\$)	Year of assessment 2015/16 (\$)	Year of assessment 2016/17 (\$)	Year of assessment 2017/18 (\$)	Year of assessment 2018/19 (\$)
Single	3,141,500	3,141,500	3,345,500	3,535,250	3,828,250
Married	4,161,500	4,161,500	4,467,500	4,657,250	4,950,250
Married + 1 child*	4,756,500	5,011,500	5,317,500	5,507,250	5,970,250
Married + 2 children*	5,351,500	5,861,500	6,167,500	6,357,250	6,990,250
Married + 3 children*	5,946,500	6,711,500	7,017,500	7,207,250	8,010,250

Being a single parent with:

	Year of assessment 2014/15 (\$)	Year of assessment 2015/16 (\$)	Year of assessment 2016/17 (\$)	Year of assessment 2017/18 (\$)	Year of assessment 2018/19 (\$)
1 child*	3,235,000	3,490,000	3,694,000	3,769,000	4,164,000
2 children*	3,830,000	4,340,000	4,544,000	4,619,000	5,184,000
3 children*	4,425,000	5,190,000	5,394,000	5,469,000	6,204,000

Add two more columns under the personal allowances table for 2018/19 and 2019/20:

Personal allowances

	2018/19	2019/20
Allowances	HK\$	HK\$
Basic allowance	132,000	132,000
Married person's allowance	264,000	264,000
Child allowance – 1st to 9th child (each)	120,000	120,000
Newborn child – additional allowance in the year of birth (each)	120,000	120,000
Single parent allowance	132,000	132,000
Dependent parent/grandparent allowance (each) (Age 55 – 59/≥60)	25,000/50,000	25,000/50,000
Additional dependent parent/grandparent allowance (each) (Age 55 – 59/≥60)	25,000/50,000	25,000/50,000
Dependent brother/sister allowance (each)	37,500	37,500
Disabled dependant allowance (each)	75,000	75,000
Personal disability allowance (Note . New allowance starting from 2018/19)	75,000	75,000
Deductions		
Self-education expenses (max.)	100,000	100,000
Elderly residential care expenses (max.)	100,000	100,000
Home loan interest (max.) #	100,000	100,000
MPF (max.)	18,000	18,000
Approved charitable donations (max.) @	35%	35%

Chapter 1 The tax system in Hong Kong
Topic list
Add the following sections to the topic list:
Page 3

- 7.12 Two-tiered profits tax rates regime
- 7.13 Transfer pricing documentation and Country-by-Country Reporting
- 7.14 Profits tax exemption to onshore privately offered Open-ended Fund Company
- 7.15 Scope of tax deductions for capital expenditure incurred for purchase of intellectual property rights expanded
- 7.16 The Inland Revenue (Amendment) (No. 6) Ordinance 2018
- 7.17 Enhanced tax deduction for expenditures incurred by enterprises on research and development activities
- 7.18 Allowing enterprises to claim tax deduction for capital expenditure incurred for procuring environmental protection installations in full in one year instead of over five years; and extending the scope of tax exemption for debt instruments under the Qualifying Debt Instrument Scheme
- 7.19 Extending profits tax exemption for eligible funds operating in Hong Kong

**Section 1.3
Pages 5
and 6**
Replace the third paragraph of section 1.3 on page 5 with:

As of 1 June 2019, Hong Kong has concluded comprehensive double taxation agreements with 40 jurisdictions including Belgium, Thailand, the mainland of China, Luxembourg, Vietnam, Brunei, the Netherlands, Indonesia, Hungary, Kuwait, Austria, the United Kingdom, Ireland, Liechtenstein, France, Japan, New Zealand, Switzerland, Portugal, Spain, the Czech Republic, Malta, Jersey, Malaysia, Mexico, Canada, Italy, Guernsey, Qatar, Korea, South Africa, United Arab Emirates ('UAE'), Romania, Russia, Latvia, Belarus, Pakistan, Saudi Arabia, India and Finland.

Modify the table in section 1.3 on page 6 as follows:

Country	CDTA/ Protocol	Gazetted	Came into force	Take effect
Latvia	CDTA	30 June 2017	24 Nov 2017	Y/A 2018/19
Belarus	CDTA	30 June 2017	30 Nov 2017	Y/A 2018/19
Pakistan	CDTA	30 June 2017	24 Nov 2017	Y/A 2018/19
New Zealand	2nd Protocol	3 Oct 2017	9 Aug 2018	9 Aug 2018
Saudi Arabia	CDTA	8 May 2018	1 Sept 2018	Y/A 2019/20
India	CDTA	4 Sept 2018	30 Nov 2018	Y/A 2019/20
Finland	CDTA	4 Sept 2018	30 Dec 2018	Y/A 2019/20

**Section 4.5
Pages 15
and 17**

Modify/add the following under section 4.5 on pages 15 and 17 as below:

A list of DIPNs issued/revised by the IRD (as at 1 June 2019) is as follows:

Modify DIPN 5 (Revised) and add DIPNs 54 and 55 to section 4.5 (Table of DIPNs) on pages 15 and 17:

No.	Subjects	Date of issue
5 (Revised)	Profits Tax Deductions for Expenditure on – <ul style="list-style-type: none"> • Technical Education • Building Refurbishment • Prescribed Fixed Assets • Environmental Protection Facilities 	April 2019
54	Taxation of Aircraft Leasing Activities	Oct 2017
55	Deduction for Research and Development Expenditure	April 2019
56	Concessionary Deductions: Section 26H to 26M Health Insurance Premiums	May 2019
57	Concessionary Deductions: Section 26N to 26U Annuity Premiums and MPF Voluntary Contributions	May 2019

Modify SOIPN Table on page 17 and 18 as follows:

No.	Subject	Date of Issue
1 (Revised)	Stamping of Agreements for Sale and Purchase of Immovable Property	November 2018
8 (Revised)	Ad Valorem Stamp Duty	November 2018

Section 5.2
Page 20

Modify the profits tax rates of section 5.2 on page 20 as follows:

		From 2008/09 to 2017/18	Starting from 2018/19	
Corporations	16.5%		First \$2m assessable profits	8.25%
			Remaining	16.5%
Partnership	Corporate partners' share of profit – 16.5%;		Corporate partners' share of profit	
			First \$2m assessable profits	8.25%
			Remaining	16.5%
			Unincorporated partners' share of profit – 15%	
Unincorporated business	Standard rate (15%)		Unincorporated partners' share of profit	
			First \$2m assessable profits	7.5%
			Remaining	Standard rate (15%)
			First \$2m assessable profits	7.5%
			Remaining	Standard rate (15%)

Modify the progressive tax rates of section 5.2 on page 20 as follows:

2017/18 (Note)	
First \$45,000	2.0%
Next \$45,000	7.0%
Next \$45,000	12.0%
Balance	17.0%

2018/19 & onwards (Note)	
First \$50,000	2.0%
Next \$50,000	6.0%
Next \$50,000	10.0%
Next \$50,000	14.0%
Balance	17.0%

**Section 5.2
Page 21****Add the following at the end of section 5.2 on page 21:**

There is a partial tax reduction for 2017/18 as a relief measure. All taxpayers liable to profits tax, salaries tax or tax under personal assessment have a reduction of 75% of the 2017/18 final tax, subject to a ceiling of \$30,000 per case.

There is a partial tax reduction for 2018/19 as a relief measure. All taxpayers liable to profits tax, salaries tax or tax under personal assessment have a reduction of 75% of the 2018/19 final tax, subject to a ceiling of \$20,000 per case.

**Section 7.3
Pages 24
and 25****Replace section 7.3 on pages 24 and 25 with the following:****7.3 Tax measures proposed by the 2019/20 Budget**

Under the 2019/20 Budget, the following tax measures were proposed:

- Reduce profits tax, salaries tax and tax under personal assessment for 2018/19 by 75%, subject to a ceiling of \$20,000 per case. For personal assessment, the ceiling of \$20,000 is applied to each single taxpayer or married person who elects for personal assessment separately from his/her spouse. If a taxpayer elects for personal assessment jointly with his/her spouse, the tax reduction is capped at \$20,000 for the couple.
- Waive the rates for all four quarters, subject to a cap of \$1,500 per quarter, for each rateable property.
- Waive business registration fees for the period from 1 April 2019 to 31 March 2020.

**Section 7.6
Pages 27
and 28****Modify the second paragraph of section 7.6 on page 27 as follows:**

As of 1 June 2019, Hong Kong has concluded TIEAs with seven jurisdictions including the United States, Denmark, the Faroes, Greenland, Iceland, Norway and Sweden.

Then, add the following before the last sentence of section 7.6 on page 28:

The Inland Revenue (Amendment) (No. 2) Ordinance 2017 was gazetted on 16 June 2017 and came into effect from 1 July 2017.

From 1 July 2017, the list of 'reportable jurisdictions' under the Inland Revenue Ordinance will be expanded to cover 75 jurisdictions, comprising those confirmed AEOI partners and prospective AEOI partners.

The Inland Revenue (Amendment) Ordinance 2018 was gazetted on 2 February 2018. The technical amendments on AEOI (i.e. clauses 5 to 11) under the (Amendment) Ordinance 2018 will come into operation on 1 January 2019 while other provisions take effect on 2 February 2018.

The (Amendment) Ordinance 2018 provides the legal framework for Hong Kong to implement multilateral tax arrangements and thereby allows more effective implementation of the arrangements relating to AEOI as well as automatic exchange of Country-by-Country Reports and spontaneous exchange of information on tax rulings under the BEPS package.

An arrangement between Hong Kong and the PRC for conducting AEOI came into effect on 6 September 2018.

Hong Kong would conduct AEOI with the PRC for the first time along with that for 49 jurisdictions. Hong Kong will continue to deliver its obligations to implement AEOI in accordance with the Common Reporting Standard promulgated by the OECD.

**Section 7.8
Page 29****Add the following before the last sentence in section 7.8 on page 29:**

Inland Revenue (Amendment) (No. 6) Ordinance 2018 was enacted on July 13 2018.

Certain preferential tax regimes (e.g. corporate treasury center) previously were applicable only to non-HK transactions. This is deemed to be harmful tax practices according to BEPS. This Amendment Ordinance has amended the preferential tax regimes with a view to meeting the international standards on countering BEPS.

As a result, the application of the concessionary tax rate of 8.25% has been extended to apply to intra-group lending transactions, corporate treasury services and corporate treasury transactions, regardless of whether Hong Kong or non-Hong Kong associates are involved.

Refer to **Chapter 3** for details.

**Section 7.11
Page 30****Add the following before the last sentence of section 7.11 on page 30:**

In July 2017, the Inland Revenue (Amendment) (No. 3) Ordinance 2017 was enacted to give profits tax concessions to corporations carrying on certain businesses in connection with aircraft.

DIPN 54 was issued in October 2017 setting out the IRD's interpretation and practice in relation to the relevant provisions under the Inland Revenue (Amendment) (No. 3) Ordinance 2017.

New sections 7.12 to 7.19 **Add the following new sections 7.12 to 7.19 after section 7.11 on page 30:**
Page 30

7.12 Two-tiered profits tax rates regime

The Inland Revenue (Amendment) (No. 3) Ordinance 2018 was gazetted on 29 March 2018. The Ordinance seeks to implement the two-tiered profits tax rates regime starting from the year of assessment 2018/19.

For corporations, the profits tax rate for the first \$2 million of assessable profits will be lowered to 8.25%. The portion of assessable profits exceeding \$2 million will continue to be subject to a rate of 16.5%. Only one corporation within a group of connected entities can enjoy the two-tiered profits tax regime.

For unincorporated businesses which are mostly partnerships and sole proprietorships, the two-tiered tax rates will correspondingly be set at 7.5% and 15%.

Refer to **Chapter 3** for details.

7.13 Transfer pricing documentation and Country-by-Country Reporting

The Inland Revenue (Amendment) (No. 6) Bill 2017 was gazetted on 29 December 2017 setting out the requirements of Master File, Local File and the implementation framework for Country-by-Country (CbC) Reporting in Hong Kong.

CbC Reporting is a minimum standard formulated by the OECD under Action 13 of the BEPS Package.

CbC Reports are to be exchanged automatically between tax authorities under relevant exchange arrangements.

Refer to **Chapter 12** for details.

7.14 Profits tax exemption to onshore privately offered Open-ended Fund Company ('OFC')

The Inland Revenue (Amendment) (No. 2) Ordinance 2018 extends profits tax exemption to onshore privately offered OFCs. This amendment ordinance has become effective since 30 July 2018.

Refer to **Chapter 4** for details.

7.15 Scope of tax deductions for capital expenditure incurred for purchase of intellectual property rights ('IPRs') expanded

The Inland Revenue (Amendment) (No. 5) Ordinance 2018 was gazetted on 29 June 2018.

This Amendment Ordinance expands the scope of profits tax deductions for capital expenditure incurred by enterprises on the purchase of IPRs from the original five types to eight types with effect from the year of assessment 2018/19.

The additional three types of IPRs are rights in layout design (topography) of integrated circuits, plant varieties and performances.

Refer to **Chapter 3** for details.

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

The Inland Revenue (Amendment) (No. 6) Ordinance 2018 was gazetted on 13 July 2018.

This Amendment Ordinance implements the minimum standards of BEPS promulgated by the OECD and codifies the transfer pricing principles into the IRO. The Amendment Ordinance aligns the IRO with the latest guidance promulgated by the OECD.

Refer to **Chapter 12** for details.

The Amendment Ordinance also amends s.8 and adds s.15BA. Please refer to Chapter 5 and Chapter 3 respectively for details.

7.17 Enhanced tax deduction for expenditures incurred by enterprises on research and development (R&D) activities

The Inland Revenue (Amendment) (No. 7) Ordinance 2018 was gazetted on 2 November 2018.

This Amendment Ordinance stipulates that R&D expenditures are classified into either 'Type A expenditures' which qualify for 100 per cent deduction or 'Type B expenditures' which qualify for enhanced tax deduction.

For 'Type B expenditures', the deduction is 300% for the first \$2 million of the aggregate amount of payments made to 'designated local research institutions' for 'qualifying R&D activities', and expenditures incurred by the enterprises for in-house qualifying R&D, and 200% for the remaining amount. There is no cap on the amount of enhanced tax deduction. The arrangement is applicable to R&D expenditures incurred by enterprises on 1 April 2018 and thereafter.

DIPN 55 was issued in April 2019 setting out the IRD's interpretation and practice on the tax deduction for R&D expenditure.

Refer to **Chapter 3** for details.

7.18 Allowing enterprises to claim tax deduction for capital expenditure incurred for procuring environmental protection installations in full in one year instead of over five years; and extending the scope of tax exemption for debt instruments under the Qualifying Debt Instrument Scheme.

Inland Revenue (Amendment) (No. 5) Bill 2018 was passed by the Legislative Council on 2 November 2018.

Starting from 2018/19, an enterprise is allowed to claim tax deduction for capital expenditure incurred for procuring environmental protection installations in full in one year instead of over five years. DIPN 5 was revised in April 2019 setting out the details.

Starting from 2018/19, the 100% profits tax exemption for debt instruments is extended to cover debt instruments of any duration.

Refer to **Chapter 3** for details.

7.19 Extending profits tax exemption for eligible funds operating in Hong Kong

Inland Revenue (Profits Tax Exemption for Funds) (Amendment) Bill 2018 was gazetted on 7 December 2018.

This Bill introduces new and self-contained provisions in the IRO so that all funds operating in Hong Kong, regardless of their structure, their location of central management and control, their size or the purpose that they serve, can enjoy profits tax exemption for their transactions in specified assets subject to meeting certain conditions. A fund can also enjoy profits tax exemption from its investment in both overseas and local private companies.

This arrangement has become effective since 1 April 2019.

Refer to **Chapter 4** for details.

Appendix Page 32

Replace the following for 'Individual Income Tax' in the Appendix on page 32:

Individual income tax on the following incomes:

- Employment income (i.e. wages and salaries)
- Remuneration for personal services such as the provision of design, accounting, legal services etc
- Author's remuneration
- Royalties
- Business operation income derived by individual entrepreneurs operating businesses
- Interest, dividends, and profit distribution
- Rental income
- Income from transfer of property
- Contingency income such as winnings, awards or other 'windfall' income

Tax rates in Appendix Page 33

Replace tax rates for 'Individual Income Tax' in the Appendix on page 33:

Individual income tax rates with effect from 1 October 2018 are as follows:

- (a) Progressive tax rates on taxable income from employment income, remuneration for personal services, remuneration for manuscripts and royalties:

Monthly taxable income (without gross up)	Tax rate
RMB	
Up to 3,000	3%
3,001 to 12,000	10%
12,001 to 25,000	20%
25,001 to 35,000	25%
35,001 to 55,000	30%
55,001 to 80,000	35%
80,001 and above	45%

(b) Progressive tax rates on business operation income

Monthly taxable income	Tax rate
RMB	
Up to 2,500	5%
2,501 to 7,500	10%
7,501 to 25,000	20%
25,001 to 41,666.67	30%
more than 41,666.67	35%

(c) The applicable IIT rate for other types of income including interest, dividends, income from leasing of property, income from transfer of property and contingency income is 20%.

Chapter 2

Administration procedures under the Inland Revenue Ordinance

Appendix
Page 85

Add the following new cases to Appendix – Summary of cases relating to administrative procedures under the IRO (page 85):

Taxpayer [Ref.]	Subject matter	Extract of facts and determination
CIR v Slipform Engineering International (HK) Limited [DCTC 1325/2016]	Recovery of tax payments	<p>The taxpayer is carrying on the business of investment holding and provision of project management services for construction contracts.</p> <p>During the years of assessment 2008/2009 and 2009/2010, substantially all of the taxpayer's relevant income was derived from project management fee income paid or receivable under various management and construction contracts entered with its related party which is an Australian company listed on the Australian Stock Exchange.</p> <p>The taxpayer had engaged affiliated companies in discharging consultation, management and administrative services for those projects.</p> <p>The IRD relied on s.61 and s.61A of the IRO to disregard the related party transactions and alleged that the transactions entered between the taxpayer and those affiliated companies were artificial or fictitious, and/or effected for the sole or dominant purpose for obtaining a tax benefit.</p>

Taxpayer [Ref.]	Subject matter	Extract of facts and determination
		<p>The taxpayer has objected to such allegations and has filed several objections.</p> <p>The court rejected the taxpayer's argument. Tax should always be paid first under s.71 notwithstanding any notice of objection or appeal, and any allegation which relates to the assessment being excessive or incorrect should not be entertained in a recovery proceeding under s.75(4).</p>
<p>CIR v Energy World (HK) Limited [DCTC 139/2017]</p>	<p>Recovery of tax payments</p>	<p>The IRD sued the taxpayer for a sum being profits tax due and unpaid under s.75 of the IRO.</p> <p>The taxpayer filed and served its defence on 30 March 2017 stating various grounds and alleging the assessment unreasonable, wrong and incorrect in law and facts.</p> <p>The IRD's striking out was launched relying on s.75(4) of the IRO.</p> <p>The court rejected the taxpayer's defence. Tax shall be paid notwithstanding any notice of objection or appeal, unless the Commissioner orders that payment of tax or any part thereof be held over pending the result of such objection or appeal.</p>
<p>CIR v Koo Ming Kown & Murakami Tadao [HCIA 1/2017] [CACV 602/2018]</p>	<p>Penalty under s.82A</p>	<p>The issues related to additional tax assessments issued to two appellants in the capacity as directors of a limited company named Nam Tai Trading Company Limited ('NTTCL') under s.82A for incorrect statements made in the tax returns of NTTCL.</p> <p>The Commissioner invoked s.82(1)(a) against the two appellants and alleged that they had made incorrect returns by understating the assessable profits of NTTCL.</p>

Taxpayer [Ref.]	Subject matter	Extract of facts and determination
CIR v The Dairy Farm Company, Limited for Dairy Farm Establishment [HCAL 234/2018] [CACV 544/2018]	Holdover	<p>On 23 November 2018, the Court of First Instance held that where a company is required to file a return under s.51(1), the company itself instead of the two appellants who signed the return should have the responsibility. Hence, s.82A(1)(a) does not allow a penalty assessment to be made on the two appellants. The Commissioner has lodged an appeal to the Court of Appeal.</p> <p>The appellants were Dairy Farm Establishment ('DFE'), a Liechtenstein incorporated entity and the owner of various trademarks registered in Hong Kong, and The Dairy Farm Company, Limited ('DFCL'), a Hong Kong incorporated private company which carries on its businesses in Hong Kong using the trademarks owned by DFE.</p> <p>Pursuant to a Licence Agreement, DFE has granted DFCL a non-exclusive licence to use various trademarks in Hong Kong. DFCL paid royalties to DFE at a percentage of the gross turnover of DFCL.</p> <p>For the years of assessments 2012/13, 2013/14 and 2014/15, the Commissioner took the view that the full amount of royalties received by DFE should be taxed under s.14 of the IRO.</p> <p>The appellants have filed an objection for the years of assessments 2012/13, 2013/14 and 2014/15. Pending the appeals, the Commissioner ordered a conditional holdover of tax due under the assessments on the condition that tax reserve certificates be purchased in respect of the full amount of tax due under all the assessments.</p>

Taxpayer [Ref.]	Subject matter	Extract of facts and determination
		<p>For the years of assessments 2015/16 and 2016/17, the Commissioner issued similar assessments to DFE and DFCL. DFE and DFCL lodged similar objections to the Commissioner in respect of the assessments for 2015/16 and 2016/17.</p> <p>Pending the determination of the above-mentioned objections, the appellants have put forwarded various proposals to the Commissioner.</p> <p>The Commissioner ordered a conditional holdover of taxes payable on the condition that a separate Tax Reserve Certificate ('TRC') be purchased for each assessment.</p> <p>The Commissioner stated that the TRCs are unique to each assessment and cannot serve as security for two sets of mutually exclusive assessments on the same profits.</p> <p>DFE and DFCL challenged the decisions by way of judicial review.</p> <p>The Court of First Instance held that the TRC is a standard form document, and there is no reason as to why the particulars of two sets of assessments in dispute cannot be appropriately stated in the blanks in the tax reserve certificate to make it clear that the certificate stands and is intended to stand as security for both assessments so as to comply with s.71(7)(e) of the IRO.</p> <p>The Commissioner has filed an appeal to the Court of Appeal.</p>

Chapter 3

Hong Kong profits tax

**Topic list
Page 103
to 104**

Add the following sections to the Topic list and renumber 6.4 as 6.5:

- 1.3 Two-tiered profits tax rates regime
- 5.9 Taxation of aircraft leasing activities
- 6.4 Changes in trading stock in s.15BA
- 10.4 Fair Value Accounting for financial instruments under ss.18G to 18L

New section 1.3 Add a new section 1.3 after section 1.2:

1.3

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1.3 Two-tiered profits tax rates regime: ss.14(2)–(5) and Schedules 8 & 8A

The Inland Revenue (Amendment) (No. 3) Ordinance 2018 was gazetted on 29 March 2018. The new law introduces a two-tiered profits tax rates regime, commencing from the year of assessment 2018/19, as follows:

Assessable profits	Tax rates	
	Corporation*	Unincorporated business
First HK\$2m	8.25%	7.5%
Over HK\$2m	16.5%	15%

* When a corporation is a partner of a partnership, the concessionary tax rate of 8.25% will only apply to the first HK\$2 million pro-rated by its share in the partnership.

1.3.1 Connected entities to nominate a single entity for the two-tiered rates

To ensure that the tax benefits will target small and medium enterprises and start-up enterprises, and to prevent income splitting among group enterprises, a group of 'connected entities' can only elect one entity within the group to enjoy the two-tiered rates for a given year of assessment (s.14AAC). The election, once made, is irrevocable.

The connected relationship is determined by their status at the end of the basis period. An entity is a connected entity of another entity if (s.14AAB(1)):

- (i) One of them has control over the other;
- (ii) Both of them are under the control of the same entity; or
- (iii) In the case of the first entity being a natural person carrying on a sole proprietorship business, the other entity is the same person carrying on another sole proprietorship business.

'Control' generally refers to having directly or indirectly more than 50% of the issued share capital, voting rights, or entitlement to capital or profits of another entity (s.14AAB(4)).

As an example, assume that Mr. Lam and Corporation G hold corporations as follows:

Business	Issued share capital/ voting rights	
	Corporation G*	Mr. Lam
Corporation A	100%	–
Corporation B	60%	40%
Corporation C	50%	50%
Corporation D	30%	70%

*Mr. Lam does not own any issued share capital and voting rights in Corporation G.

Corporation G, Corporation A and Corporation B are connected entities. Only one of them can elect two-tiered profits tax rates.

Corporation C and Corporation D have no connected entity and qualify for two-tiered profits tax rates.

If Corporation B owns 70% of the issued share capital of another company, such as Corporation E, Corporation G owns or controls 42% (i.e. $60\% \times 70\%$) in aggregate of the issued share capital/is entitled to exercise, or controls the exercise, of 42% in aggregate of the voting rights in Corporation E. In this regard, Corporation E is a connected entity of Corporation B. Corporation E can elect two-tiered profits tax rates if Corporation B does not elect.

1.3.2 No double benefits for taxpayers that are eligible for the preferential half-rate tax regimes: s.14(5)

To avoid double benefits, if a corporation has elected to be subject to the preferential half-rate tax regimes for qualifying profits derived from their businesses of reinsurance, captive insurance, corporate treasury centres, aircraft leasing or aircraft leasing management under ss.14B(2)(a), 14D(5)(b), 14H(4)(b) or 14J(5)(b) (see the discussion in **section 5.2** on 'Concessionary trading receipts chargeable to tax at half of the profits tax rate'), it will be excluded from the two-tiered profits tax rates regime. The remaining non-qualifying profits will be subject to the full tax rate.

1.3.3 Income from qualifying debt instruments not counted towards the first HK\$2 million threshold

Profits derived from qualifying debt instruments which are already taxed at the half rate under s.14A (see the discussion in **section 5.2** on 'Concessionary trading receipts chargeable to tax at half of the profits tax rate') will not be counted towards the first HK\$2 million threshold under the two-tiered profits tax rates regime. Unlike the above preferential half-rate tax regimes for reinsurance, captive insurance, corporate treasury centres, aircraft leasing and aircraft leasing management, the entity itself is not excluded from the two-tiered profits tax rates regime.

Section 5.1 Page 134 to 136

Section	Sums specifically chargeable to profits tax
15(1)(b)	Add the following paragraph after the first paragraph: With effect from 29 June 2018, the scope of s.15(1)(b) was expanded to include layout-design (topography) of an integrated circuit, performer's right and plant variety right.

Add the following sections in the table:

Section	Sums specifically chargeable to profits tax
15(1)(bb)	Sums received by or accrued to a performer or an organiser for an assignment of, or an agreement to assign, a performer's right in relation to a performance given by the performer in Hong Kong on or after 29 February 2018.

Section	Sums specifically chargeable to profits tax
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'Organiser' means a person who obtains a performer's right in a performance in Hong Kong through arranging the participation of the performer in the performance or managing the performance (s.15(8)).

'Performance' and 'performer' have the meanings given by s.200(2) of the Copyright Ordinance (s.15(8)).

S.21A has no application, but the withholding obligation under s.20B applies.

15(1)(bc)	<p>Sums received by or accrued to a person for the use, or the right to the use, outside Hong Kong of any intellectual property (IP) or know-how generated from any R&D activity which is deductible under s.16B in ascertaining profits of the person under profits tax; or for imparting knowledge connected with the use outside Hong Kong of any such IP or know-how.</p>
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'IP' includes copyright material, a design, a layout-design (topography) of an integrated circuit, a patent, a plant variety right, a secret process or formula; and any other property or right of a similar nature (s.15(8)).

'Know-how' means any industrial information or techniques likely to assist in the manufacture or processing of goods or materials (s.15(8)).

15(1)(ib)	<p>Sums received by or accrued to a LAC banking entity by way of interest in respect of a regulatory capital security that arises through or from the carrying on of its business in Hong Kong, even if the moneys laid out for the acquisition of the security in respect of which the interest is received or accrues are made available outside Hong Kong.</p>
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'LAC banking entity' means a Hong Kong affiliated operational entity, as defined by rule 2(1) of the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements – Banking Sector) Rules, that is required to meet a banking LAC requirement under those Rules; or a clean Hong Kong holding company, as defined by rule 2(1) of those Rules, that is required to meet a banking LAC requirement under those Rules (s.2(1)).

15(1)(lb)	<p>Sums received by or accrued to a LAC banking entity by way of gains or profits that arises through or from the carrying on of its business in Hong Kong from the sale or disposal, or on the redemption on maturity or presentment of a regulatory capital security, even if (i) the moneys laid out for the acquisition of the security were made available outside Hong Kong; or (ii) the sale, disposal or redemption is effected outside Hong Kong.</p>
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Section	Sums specifically chargeable to profits tax
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|----------|--|
| 15(1)(n) | <p>Sums received by or accrued to a corporation by way of gains or profits (other than those arising from the sale of capital assets) arising through or from the carrying on in Hong Kong by the corporation of:</p> <ul style="list-style-type: none"> (i) Its business of granting a right to use an aircraft to another person (aircraft business), even if the aircraft is used outside Hong Kong; or (ii) Its business of managing a corporation carrying on an aircraft business or of managing an aircraft business, even if the aircraft concerned is used outside Hong Kong. |
|----------|--|

The taxation of aircraft leasing activities is discussed in **section 5.9**.

Example 15
Pages 137
and 138

In part (a) of the solution, revise the tax rate of 15% to 7.5%, and the profits tax payable of \$4,500 to \$2,250 (under the two-tiered profits tax regime).

In part (b) of the solution, revise the tax rate of 15% to 7.5%, and the profits tax payable of \$9,000 to \$4,500 (under the two-tiered profits tax regime).

In part (c) of the solution, revise the tax rate of 15% to 7.5%, and the profits tax payable of \$30,000 to \$15,000 (under the two-tiered profits tax regime).

Section 5.1
Page 138 to
139

Revise the table under other deemed trading receipts as follows:

Section	Sums specifically chargeable to profits tax
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16B(3) changed to 16B(5)	<p>Replace the paragraph with the following:</p> <p>Proceeds from sale of any plant or machinery for, and rights generated from, R&D activities previously allowed as a deduction under s.16B(2). The taxable amount is limited to the amount of the deduction.</p>
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16J(3) changed to 16J(3), (3A) and (5)	<p>Replace the paragraph with the following:</p> <p>Proceeds from sale of an environmental protection installation ('EPI') previously allowed as a deduction under s.16I(3), (3A) and (3B) that exceeds the unallowed amount (if any). The taxable amount is limited to the amount of the deduction.</p>
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Section 5.2
Page 139

Under section 5.2 'Concessionary trading receipts chargeable to tax at half of the profits tax rate', replace the first paragraph with the following paragraph, and add the following sections after s.14D in the table:

Income derived from qualifying debt instruments (short or medium term), assessable profits of an insurance company derived from qualifying business of reinsurance or insurance of offshore risks, qualifying profits of a qualifying corporate treasury centre, qualifying aircraft lessor and qualifying aircraft leasing manager, are only taxed at half of the profits tax rate.

Taxpayer	Concessionary trading receipts chargeable to tax at half of the profits tax rate
14H	Qualifying profits derived from qualifying aircraft leasing activity carried on by a qualifying aircraft lessor, effective from 1 April 2017 (discussed in section 5.9 on 'Taxation of aircraft leasing activities'). An election for the tax concession, once made, is irrevocable.
14J	Qualifying profits derived from qualifying aircraft leasing management activity carried on by a qualifying aircraft leasing manager, effective from 1 April 2017 (discussed in section 5.9 on 'Taxation of aircraft leasing activities'). An election for the tax concession, once made, is irrevocable.

**Page 139
to 140**

Key terms in s.14A(4)

Under 'Debt instrument', add 'or listed on a stock exchange in Hong Kong' to the end of (a).

Under 'Medium term debt instrument', add 'but before 1 April 2018' after 'A debt instrument that is issued on or after 5 March 2003' in (b).

Under 'Short term debt instrument', add 'but before 1 April 2018' after 'is issued on or after 25 March 2011' in (a).

**Section 5.3
Page 141**

Add the following sections after s.14(1) and s.26A(1)(c) respectively in the table:

Section	Sums specifically exempt from profits tax
14A(1B)	Sums received by or accrued to a person as interest paid or payable on a debt instrument on or after 1 April 2018, and any gain or profit on the sale or other disposal, or on the redemption on maturity or presentment, of the debt instrument. See the table in section 5.3 below for details.
26A(1)(ca) and (cb)	Additional payments on and profit on sale or other disposal of, or on redemption on maturity of, an alternative bond issued in connection with a borrowing by the Government under the Loans Ordinance.

Section 5.3
Page 142

Under 'Long term debt instrument', add 'but before 1 April 2018' to the end of (a).
Replace the table in section 5.3 with the following:

Summary of tax treatments for interest on and profit from qualifying debt instruments					
Period of maturity	Issued before 5/3/2003	Issued between 5/3/2003 & 24/3/2011	Issued on or after 25/3/2011 & before 1/4/2018	Issued on or after 1/4/2018	IRO section
< 5 Years	Full tax rate	–	–	Exempt	14(1), 14A(1B)
≥ 5 Years	Half of tax rate	–	–	Exempt	14A(1) & (1B)
< 3 Years	–	Full tax rate	Half of tax rate	Exempt	14(1), 14A(1) & (1B)
≥ 3 Years but < 7 Years	–	Half of tax rate	Half of tax rate	Exempt	14A(1) & (1B)
≥ 7 Years	–	Exempt	Exempt	Exempt	26A(1)(h) & (i), 14A(1B)

Section 5.7.1
Page 156

Under Key terms in ss.14C, 14D and Schedule 17B, replace (a) of 'A CTC qualifies as a 'qualifying corporate treasury centre' ('QCTC') if (ss.14D(2) and (3)):' with the following:

- (a) It is a standalone entity carrying out one or more of the following **corporate treasury activities** in Hong Kong:
- (i) Carrying on an intra-group financing business;
 - (ii) Providing corporate treasury services;
 - (iii) Entering into corporate treasury transactions; or

Section 5.7.1
Page 157

Add the following paragraph before the sentence 'S.14D(9) specifies that a FI is not eligible to be a QCTC.'

To ensure that the corporation has appropriate substance in Hong Kong, effective from the year of assessment 2018/19, the Commissioner may prescribe thresholds for determining whether these conditions have been met (s.26AB). These thresholds may stipulate the number of full-time employees in Hong Kong who perform these activities, including their qualifications, and the amount of operating expenditure incurred in Hong Kong for the activities. Failure to comply with these thresholds will result in the corporation being taxed at the full profits tax rate.

Replace 'S.14D(9) specifies that a FI is not eligible to be a QCTC.' with the following:

S.14D(9) specifies that a FI or LAC banking entity is not eligible to be a QCTC.

Add 'Intra-group lending transaction' after 'Intra-group financing business':

'Intra-group lending transaction' is defined in s.14C(1) to mean, in relation to a corporation, a transaction under which the corporation lends money, in the ordinary course of its intra-group financing business, to its associated corporation.

Section 5.7.1 Page 158	Delete the definition of 'Non-Hong Kong associated corporation'.
Section 5.7.1 Page 159	Delete the second paragraph under Corporate treasury service. Delete the heading 'Corporate treasury transaction' and the paragraph that follows.
Section 5.7.1 Page 161	<p>Replace the first paragraph under the heading 'Qualifying profits at concessionary tax rate of 8.25%' with the following paragraph and delete the second paragraph:</p> <p>The half rate concession only applies to qualifying profits (s.14D(1)), i.e. profits derived from the following qualifying transactions or services:</p> <ul style="list-style-type: none"> (a) Money lent to an associated corporation in the ordinary course of an intra-group financing business. (b) Corporate treasury services provided to an associated corporation. (c) Corporate treasury transactions entered into by a QCTC on its own account and related to the business of an associated corporation.
Section 5.7.1 Page 162	Delete the entire page.
Section 5.7.1 Page 163	Delete the first paragraph of the page.
Section 5.8.1 Page 164	<p>Replace paragraph (e) with the following:</p> <p>Distributions received from RCS and the profits from the disposal or redemption of RCSs are to be treated as taxable trading receipts under ss.15(1)(f), (g), (i), (ia), (ib), (j), (k), (l), (la) and (lb).</p>
Section 5.8.1 Page 165	<p>Under Key terms in s.17A, replace 'Regulatory capital security' with the following:</p> <p>'Regulatory capital security' means (s.17A(1)):</p> <ul style="list-style-type: none"> (a) a security that, for the purposes of the Banking (Capital) Rules or of the equivalent laws or regulatory requirements of another member jurisdiction of the Basel Committee – <ul style="list-style-type: none"> (i) qualifies or has qualified as an Additional Tier 1 ('AT1') capital instrument; and (ii) forms or formed a component of AT1 capital; (b) a security that, for the purposes of the Banking (Capital) Rules or of the equivalent laws or regulatory requirements of another member jurisdiction of the Basel Committee – <ul style="list-style-type: none"> (i) qualifies or has qualified as a Tier 2 ('T2') capital instrument; and (ii) forms or formed a component of T2 capital; (c) an instrument issued by a FI that, for the purposes of the Financial Institutions (Resolution) (Loss-absorbing Capacity Requirements – Banking Sector) Rules – <ul style="list-style-type: none"> (i) qualifies or has qualified as a banking non-capital LAC debt instrument; and (ii) forms or formed a component of banking loss-absorbing capacity;

New section 5.9 **Add a new section 5.9 after section 5.8.3:**
Page 171 **5.9 Taxation of aircraft leasing activities**

To strengthen the development of offshore aircraft leasing activities in Hong Kong, thereby enhancing the status of Hong Kong as an international financial centre and the soft power of Hong Kong in being an international aviation hub, the Inland Revenue (Amendment) (No. 3) Ordinance 2017 was enacted on 7 July 2017 to:

- (a) Provide a half-rate concession for **qualifying aircraft lessors** ('QAL') and **qualifying aircraft leasing managers** ('QALM');
- (b) Provide a 20% tax base concession for QAL;
- (c) Introduce a new deeming provision for gains or profits arising through or from aircraft leasing business or aircraft leasing managing business carried on in Hong Kong; and
- (d) Limit the amount of tax deduction that can be claimed by a payer who is connected with a QAL or a QALM chargeable to tax at the concessionary tax rate.

The IRD issued DIPN 54 in October 2017 to provide guidance on the application of the profits tax provisions in relation to aircraft leasing activities.

5.9.1 Concessionary tax regime

Under the concessionary tax regime, effective from 1 April 2017:

- (a) Qualifying profits of QAL and QALM will be taxed at the concessionary tax rate of 8.25% (i.e. 50% of the current profits tax rate of 16.5%) (ss.14H(1) and 14J(1)).
 Qualifying profits include incidental income such as interest income, exchange gains or hedging gains, to the extent that the relevant transactions are ancillary to the qualifying activities (DIPN 54, paras. 11 and 38).
- (b) In lieu of tax depreciation allowances, the deemed taxable amount in respect of income derived from the leasing of aircraft to an aircraft operator by a QAL will be equal to 20% of the net rentals, i.e. gross rentals less deductible expenses, but excluding tax depreciation allowances (s.14I).

The half-rate concession applies to a QAL and a QALM for a year of assessment only if:

- (a) The central management and control ('CMC') of the corporation must be exercised in Hong Kong (**the CMC requirement**) (ss.14H(4)(a)(i) and 14J(5)(a)(i));
- (b) The profit generating activities must be carried out in Hong Kong by the corporation; or arranged by the corporation to be carried out in Hong Kong (**the substantial activity requirement**) (ss.14H(4)(a)(ii) and 14J(5)(a)(ii));
- (c) Those activities are not carried out by a permanent establishment outside Hong Kong (**the attribution to Hong Kong requirement**) (ss.14H(4)(a)(iii) and 14J(5)(a)(iii));
- (d) The corporation must be a corporation that is not an aircraft operator, and only carries out qualifying aircraft leasing activities or qualifying aircraft leasing management activities and no other activities in Hong Kong (**the standalone corporation requirement**) (ss.14H(2), 14J(2)(a), 2(b)(i) & (3); and
- (e) The corporation has elected in writing that the half-rate concession applies to it (ss.14H(4)(b) and 14J(5)(b)).

An aircraft lessor or an aircraft leasing manager will have its CMC in Hong Kong if its executive officers and senior management predominantly exercise day-to-day responsibility for the strategic, financial and operational policy decision making of the entity in Hong Kong and predominantly conduct the day-to-day activities necessary for making such decisions in Hong Kong (DIPN 54, para. 61).

To satisfy 'the substantial activity requirement', the core income generating activities which produce the qualifying profits of a QAL or a QALM, need to be carried out in Hong Kong. Such activities include raising funds, agreeing funding terms, identifying and acquiring aircraft to be leased, soliciting lessees, setting the terms and duration of leases, monitoring and revising lease agreements, managing any risks and maintaining documentation (DIPN 54, para. 67).

In order to assist the IRD to consider whether 'the substantial activity requirement' is satisfied, it is important for taxpayers to submit a realistic business plan for carrying out their aircraft leasing activities in Hong Kong in the year in which the aircraft leasing activity commences. For lessors that are established as an SPV to hold an aircraft, it may be necessary to consider whether such an SPV has sufficient connection or nexus with the active conduct of aircraft leasing activity in Hong Kong, including the engagement of an aircraft leasing manager carrying on business in Hong Kong (DIPN 54, para. 70).

Example 1 (Adapted from DIPN 54, Example 8)

Overseas Trading Company-F set up SPV-HK, a QAL in Hong Kong, for holding a private jet which was leased to the company at a non-arm's length rent. SPV-HK did not have employees in Hong Kong and was not managed by a QALM in Hong Kong. It had two nominee directors and used the business address of a Hong Kong secretarial firm as its registered address.

It appears that the above leasing arrangement might be used for shifting overseas income to the half-rate regime in Hong Kong for tax avoidance purpose. SPV-HK did not have business substance in Hong Kong except merely owning the private jet. In the circumstances, the Commissioner would not accept that the CMC and substantial activity requirements were satisfied.

In determining whether a corporation has carried out any activity other than a qualifying aircraft leasing activity or qualifying aircraft leasing management activity, only activities that generate income to the corporation are to be taken into account (ss. 14H(3) and 14J(4)). Therefore, expense transactions such as taking a lease in respect of the business premises for carrying out qualifying aircraft leasing activities or sponsoring an international industry conference for marketing purpose would be excluded (DIPN 54, para. 15).



Key terms in ss.14G(1) and Schedule 17F

'**Aircraft**' includes an aeroplane, airframe, aircraft engine and helicopter; but does not include an aircraft solely for military use, airship, spacecraft or satellite.

'**Aircraft leasing activity**' is defined in s.1 of Schedule 17F to mean leasing an aircraft by the corporation to an aircraft operator.

'**Aircraft operator**' means a person carrying on an aircraft operation business.

'**Aircraft operation business**' means a business of operating aircraft as an owner or a charterer for providing services for the carriage by air of passengers, cargo or mail; but does not include dealing in aircraft or agency business in connection with air transport.

'Aircraft leasing management activity' is defined in s.1 of Schedule 17F to mean any of the following activities:

- (a) Managing another corporation that is a relevant QAL;
- (b) Establishment or administration of a special purpose entity for the purpose of owning an aircraft by that entity;
- (c) Providing finance in obtaining the ownership of an aircraft by a special purpose entity wholly or partly owned by the corporation or its associated corporation;
- (d) Providing a guarantee in respect of a financial or performance obligation as regards the aircraft leasing business of a special purpose entity wholly or partly owned by the corporation or its associated corporation, or granting security in respect of that business;
- (e) Managing leases;
- (f) Arranging for the procurement or leasing of aircraft;
- (g) Arranging for the operation, maintenance, repair, insurance, storage, scrapping or modification of aircraft;
- (h) Arranging for the evaluation, appraisal, provision or inspection of aircraft, airline facilities or maintenance facilities for aircraft;
- (i) Arranging for the assessment of the aviation and aircraft market conditions;
- (j) Marketing of leases that are operating leases;
- (k) Providing finance in obtaining the ownership of an aircraft by an airline enterprise from another corporation that is a relevant QAL;
- (l) Providing a residual value guarantee or contingent purchase arrangement;
- (m) Providing services in relation to an aircraft leasing activity for or to another corporation that is a relevant QAL.

'Lease', when used as a noun, means a dry lease; but does not include a dry lease that is a funding lease, hire-purchase agreement or conditional sale agreement; and when used as a verb, is to be construed accordingly.

'Dry lease' means an arrangement under which:

- (a) An aircraft is bona fide demised, let or hired out, or a right to use an aircraft is otherwise granted, by a person (lessor) to another person for a term exceeding one year;
- (b) The lessor is not responsible for ensuring the airworthiness of the aircraft; and
- (c) No member of the crew of the aircraft is employed by the lessor.

5.9.2 Tax treatment for qualifying aircraft lessor

The tax concession

The tax rate on the qualifying profits of a QAL will be only 8.25%, and this reduced tax rate will be applied to only 20% of the usual tax base of the QAL (i.e. gross lease payments less deductible expenses, excluding tax depreciation allowances). As a result, the effective tax rate on the net lease payments derived from the offshore leasing of aircraft by a QAL will be 1.65% only (i.e., $20\% \times 8.25\%$) (s.14I(1) and (2)). If the half-rate concession applies to a corporation, it will not be entitled to any tax depreciation allowances (s.14H(7)).

Qualifying profits generally refer to profits derived from the leasing of an aircraft owned by the QAL in its ordinary course of business in Hong Kong to a non-Hong Kong aircraft operator (i.e., profits derived from such qualifying aircraft leasing activities). **'Non-Hong Kong aircraft operator'** means an aircraft operator who is not chargeable to profits tax in Hong Kong.

An aircraft leasing activity carried out by a corporation in respect of an aircraft is a **'qualifying aircraft leasing activity'** if (s.14G(6)):

- (a) The activity is carried out in the ordinary course of the corporation's business carried on in Hong Kong; and
- (b) The aircraft is owned by the corporation when the activity is carried out.

The word 'own' in s.14G(1) refers to economic ownership, and includes holding an aircraft:

- (a) As a lessee under a funding lease;
- (b) As a bailee under a hire-purchase agreement; and
- (c) As a buyer under a conditional sale agreement.

If the aircraft lessor acquires an aircraft through these financing arrangements, the ownership of the aircraft would be regarded as having been acquired by the aircraft lessor even though legal title to the aircraft has not yet been transferred to the aircraft lessor (DIPN 54, para. 33). However, if the property in the aircraft would unlikely pass to the aircraft lessor, the aircraft would not be regarded as having been acquired by the aircraft lessor. Thus, leasing of such an aircraft to an aircraft operator would not qualify for the tax concessions (DIPN 54, para. 35).

If an aircraft lessor grants a right to use an aircraft to an aircraft operator under a funding lease, hire-purchase arrangement or conditional sale agreement, the ownership of the aircraft in effect is transferred to the aircraft operator and thus the aircraft lessor will not qualify for the tax concessions (DIPN 54, para. 24).



Example 2 (Adapted from DIPN 54, Example 10)

Qualifying Aircraft Lessor-HK granted the right to use an aircraft to Aircraft Operator-HK under a hire-purchase agreement with a purchase option. Aircraft Operator-HK then leased the aircraft to Aircraft Operator-F, a non-Hong Kong aircraft operator.

Aircraft Operator-HK would be regarded as having obtained ownership of the aircraft. However, it would not be granted depreciation allowances under s.39E despite that s.23C would apply to assess the charter hire received from Aircraft Operator-F.

As for Qualifying Aircraft Lessor-HK, the hire-purchase agreement would fall outside the definition of 'lease' under s.14G(1) and hence Qualifying Aircraft Lessor-HK is not entitled to the profits tax concessions under the aircraft leasing regime. The interest element of the lease payments received would be assessed at full rate.

If Qualifying Aircraft Lessor-HK granted the right to use the aircraft to Aircraft Operator-HK by way of an operating lease, Qualifying Aircraft Lessor-HK could elect into the aircraft leasing regime to enjoy the profits tax concessions.

In order to qualify for the concession, the aircraft must be owned by the corporation claiming the concession. However, there may be a commercial need to interpose an intermediate lessor set up in the lessee jurisdiction or a third jurisdiction (e.g. to isolate financial risks or to allow for easier transfer of the aircraft). Under the arrangement, the intermediate lessor, which is not itself an aircraft operator, leases an aircraft from the

lessor and then on-leases the same to an aircraft operator. Nonetheless, the IRD would carefully examine the facts of each case in order to ascertain if a leasing arrangement involving the interposition of an intermediate lessor is one for which the profits tax concession was intended. In the absence of any tax avoidance arrangement, the IRD may consider that the 'ownership' requirement is satisfied and allow the lessor in such situation to enjoy the proposed tax concessions (DIPN 54, paras. 22 and 37).

Therefore, leases transferring title or giving an option to acquire the aircraft will not qualify for the concession. However, where a separate agreement provides a purchase option which merely allows the lessee to acquire the aircraft at its fair market value at the end of the lease, this will be treated as a separate transaction not connected with the lease, thereby allowing the lessor to qualify for the tax concession (DIPN 54, para. 27).

20% tax base concession

A QAL will be denied the 20% tax base concession under the following circumstances (s.14I(3)):

- (a) The lessor has not incurred capital expenditure on the provision of the aircraft concerned;
- (b) The QAL or its connected person has been granted tax depreciation allowances in Hong Kong in respect of the aircraft concerned; or
- (c) Capital allowances are granted to a connected person of the QAL, whether in Hong Kong or in a territory outside Hong Kong, for the year of assessment in question in respect of the capital expenditure on the provision of the aircraft concerned.

If an aircraft is leased to an aircraft operator together with other dealings in pursuance of one bargain, for calculating the net lease payments, the Commissioner is empowered to allocate an amount of gross lease payments for the right to use the aircraft under the lease having regard to all the circumstances of the bargain (s.14I(4)). However, s.14I(4) would apply if the terms of the lease and other dealings are negotiated together such that the gross lease payments would not reflect the market rental of the aircraft.



Example 3 (Adapted from DIPN 54, Example 1)

In a sale and leaseback transaction, an aircraft operator sold an aircraft to a QAL at a deflated price. In return, it could lease back the aircraft from the QAL at a deflated monthly lease payment for a fixed period of time.

Since the sale price of the aircraft and gross lease payments are negotiated together in pursuance of one bargain, the Commissioner could adjust the gross lease payments under s.14I(4).

Aircraft held for three years or more to be treated as capital assets

An aircraft owned by a QAL is to be treated as a capital asset of the QAL if the QAL (s.14H(8)):

- (a) has used the aircraft for carrying out a qualifying aircraft leasing activity for a continuous period of not less than three years immediately before the QAL disposes of the aircraft; and
- (b) the half-rate concessionary treatment applies in respect of the leasing of the aircraft for all relevant years of assessment.

Therefore, a QAL satisfying the above conditions would not be liable to Hong Kong profits tax in respect of gains derived from the disposal of an aircraft.

5.9.3 Tax treatment for qualifying aircraft leasing manager

The tax concession

The tax rate on the qualifying profits of a QALM will be only 8.25%. Qualifying profits generally refer to profits derived by the QALM from performing aircraft leasing management activities for a QAL in the ordinary course of the business of the QALM in Hong Kong (i.e., profits derived from such qualifying aircraft leasing management activities).

An aircraft leasing management activity carried out by a corporation in respect of an aircraft is a **'qualifying aircraft leasing management activity'** if (s.14G(7)):

- (a) The activity is carried out in the ordinary course of the QALM's business carried on in Hong Kong;
- (b) The activity is carried out for a QAL in respect of an aircraft owned by the QAL, and is leased to an aircraft operator, when the activity is carried out.

When, at the request of a relevant QAL, a QALM provides finance to an airline enterprise for acquiring an aircraft from the relevant QAL, the QALM is assisting the QAL to dispose of an aircraft. Such activity is regarded as having been carried out for the relevant QAL and would qualify for the profits tax concession if other criteria are satisfied (DIPN 54, para. 45).

Safe harbour rule under s.14K

If a corporation is not dedicated solely to carrying out one or more of the qualifying aircraft leasing management activities, it may still qualify as a QALM if it satisfies the prescribed safe harbor rules. A corporation satisfies the safe harbor rule for a year of assessment if it falls within the one-year safe harbor or the multiple-year safe harbour (s.14K(1)).

- (a) **One-year safe harbour** – passes both the aircraft leasing management profits ('ALMP') and aircraft leasing management assets ('ALMA') tests for the year of assessment concerned (s.14K(2)).
- (b) **Multiple-year safe harbour** – the average percentages of the ALMP and ALMA for the year of assessment concerned and the preceding one* or two years of assessment passes both tests (s.14K(3)).

(* if the corporation carries on a business in Hong Kong for less than two years, or has less than two 'consecutive' years of track record (s.14K(4)).



Example 4 (Adapted from DIPN 54, Example 7)

Aircraft Leasing Manager-HK claimed the half rate concession for Year 4. It had the following track record:

Year	Business activity in Hong Kong
Year 1	Active business
Year 2	Dormant business
Year 3	Active business
Year 4	Active business

Though Aircraft Leasing Manager-HK had three years of active business operations in Hong Kong, it was dormant in Year 2, leaving it with just one-year prior to the subject year. Therefore, Aircraft Leasing Manager-HK would be regarded as having two years of track record. The average ALMP and ALMA percentages would be computed based on the audited financial statements for Years 3 and 4.

The **ALMP test** is satisfied if the ALMP are not lower than **75% of the total profits**, which is calculated based on the accounting profits irrespective of the source of profits. ALMP means any profits derived from qualifying aircraft leasing management activities (s.14G(1)). If there is substantial loss in exceptional circumstances (e.g. the QAL has become insolvent and the debt has become bad), the Commissioner would consider excluding the loss when computing the percentage for the sale harbour rule (DIPN 54, para. 52).

The **ALMA test** is satisfied if the ALMA are not lower than **75% of the total assets**, which is calculated based on the audited accounts irrespective of the location of the assets. The ALMA include fixed assets that are used to carry out the qualifying aircraft leasing management activities, e.g. office equipment. The ALMA are apportioned if they are partly used for carrying out a qualifying aircraft leasing management activity and partly for another purpose (s.14K(7)).

If an aircraft leasing manager also acts as the holding company for a leasing group, the Commissioner is prepared to exclude equity investments in group companies and dividends from the denominators (i.e. total profits or assets) in calculating the ALMP and ALMA percentages.



Formula to learn (s.14K(5) and (6))

$$\text{ALMP percentage} = \frac{\text{ALMP}}{\text{P}}$$

where:

ALMP means the aggregate amount of the aircraft leasing management profits of the corporation in the basis period for the year of assessment; and

P means the aggregate amount of profits accruing to the corporation from all sources, whether in Hong Kong or not, in the basis period for the year of assessment.

$$\text{ALMA percentage} = \frac{\text{ALMA}}{\text{A}}$$

where:

ALMA means the aggregate value of the aircraft leasing management assets of the corporation as at the end of the basis period for the year of assessment; and

A means the aggregate value of all assets, whether in Hong Kong or not, of the corporation as at the end of the basis period for the year of assessment.

Commissioner's determination

If neither of the above conditions are satisfied, the Commissioner may, on application by a taxpayer, exercise his discretion to determine that the corporation is a QALM if he is of the opinion that the conditions specified in s.14J(3) or the safe harbour rule in s.14K would, in the ordinary course of business of the corporation, have been satisfied for the year of assessment (s.14L).

5.9.4 Election for the concessionary tax rate

An election in writing to apply the concessionary tax rate must be made by the QAL (ss.14H(4)(b)) and QALM (ss.14J(5)(b)). Once made, the election is irrevocable (ss.14H(5) and s.14J(6)) for so long as the lessor or manager remains as a QAL or a QALM.

Where a QAL or a QALM has made an election but failed to qualify as a QAL or a QALM for a particular year (cessation year), the lessor or the manager will be denied the profits tax concessions for that year and the subsequent year of assessment (ss.14H(6)(b) and 14J(7)(b)). This is to prevent abuse and protect fiscal revenue as a corporation may opt in when it derives profits from qualifying operations in order for the concessionary half rate to apply; and opt out when it suffers losses in a subsequent year in order to obtain deduction of losses at full rate. A fresh election is required to be made when the QAL and QALM are entitled to the half rate concession again (ss.14H(6)(a) and 14J(7)(a)).

If a QAL or a QALM merely incurs a tax loss from its qualifying operations, it would not be disqualified from being entitled to the half rate concession. S.14H(1) or 14J(1) still applies and the tax loss can only be set off against its other types of profits at half rate for the purpose of s.19CA. Ss.14H(6)(b) and 14J(7)(b) would not be invoked to deny profits tax concessions to the qualifying corporation for the subsequent year of assessment.

5.9.5 Anti-avoidance provisions in s.14M

The chargeable profits from a transaction between a QAL and its associate in connection with a qualifying aircraft leasing activity should be determined by reference to the amount of profits that would have accrued had the same transaction been carried out at arm's length terms between parties who are not associates (ss.14M(1) and (2)). This arm's length principle also applies to a qualifying aircraft leasing management activity between a QALM and its associate (ss.14M(3) and (4)).

Ss.14M(1) to (4) sets out the conditions where the profits in respect of transactions in connection with a qualifying aircraft leasing activity or a qualifying aircraft leasing management activity between a qualifying entity and its associates may be subjected to adjustment.

Under the aircraft leasing regime, a QAL can own an aircraft via a funding lease, a hire-purchase agreement or a conditional sale agreement. A QAL may defease such ownership arrangement to a third party. The third party takes up the primary obligation to make payments to the head lessor, bailor or seller. The effect of a defeased arrangement is that the QAL is no longer obliged to make payments under the ownership arrangement, and the QAL would be treated as if it had ceased to own the aircraft. Hence, no profits tax concessions will be granted to the QAL in respect of the leasing transaction with the aircraft operator as it is no longer a qualifying aircraft leasing activity as defined in s.14G(6) (s.14M(5)).

5.9.6 Anti-arbitrage provision in s.16(1A)

To prevent tax arbitrage through aircraft leasing transactions between connected persons, s.16(1A) is enacted. Where a Hong Kong aircraft operator (i.e. the lessee) is connected with a QAL or a QALM who is only chargeable to tax at the 8.25% concessionary tax rate in respect of a sum paid by the lessee, the amount of tax deduction that can be claimed by the lessee will be reduced by reference to the amount of tax reduction enjoyed by the QAL or QALM under the concessionary tax regime, i.e. the half-rate concession. Therefore, when ascertaining the amount of deduction that could be allowed to the connected person under s.16(1A), the 20% tax base concession would be ignored.

Connected person, in relation to a corporation, means (s.14G(1)):

- (a) An associated corporation of the corporation;
- (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; or
- (c) A partnership in which the corporation or its associate is a partner.

Where the payer and the recipient are both taxpayers qualifying for the concessionary tax regime, there would be no tax arbitrage and s.16(1A) would have no application. Hence, s.16(1A) will not be invoked to restrict deduction of management fees paid by a QAL to a connected QALM for qualifying aircraft leasing management services provided as their profits are assessed at half tax rate (DIPN 54, para. 82).



Example 5 (Adapted from DIPN 54, Example 11)

Qualifying Aircraft Lessor-HK leased an aircraft to Aircraft Operator-HK which was a connected person. The lease payment charged by Qualifying Aircraft Lessor-HK for the year of assessment 2017/18 was \$12 million. Qualifying Aircraft Lessor-HK had not claimed depreciation allowances in respect of the aircraft before and elected for the half rate concession. Its operating expenses amounted to \$7 million for that year.

Profits tax payable by Qualifying Aircraft Lessor-HK

$$= (\$12,000,000 - \$7,000,000) \times 20\% \times 8.25\%$$

$$= \$1,000,000 \times 8.25\%$$

$$= \underline{\underline{\$82,500}}$$

Reduction in the profits tax payable by Qualifying Aircraft Lessor-HK

$$= (\$1,000,000 \times 16.5\%) - \$82,500$$

$$= \underline{\underline{\$82,500}}$$

Amount of the lease payment deductible by Aircraft Operator-HK

$$= \$12,000,000 - (\$82,500 \div 16.5\%)$$

$$= \underline{\underline{\$11,500,000}}$$

5.9.7 Deeming provision in s.15(1)(n)

With effect from 7 July 2017, gains or profits (other than those arising from the sale of capital assets) received by or accrued to a corporation from its aircraft leasing business or aircraft leasing management business in Hong Kong, would be deemed profits chargeable to tax in Hong Kong, notwithstanding that the aircraft concerned is used outside Hong Kong.

Section 6.3.4 Add the following paragraph before section 6.4: Page 176

The position is now governed by s.15BA which applies to a change in trading stock on or after 13 July 2018 as discussed in section 6.4 below.

New section 6.4 Add a new section 6.4 and renumber the original section 6.4 as 6.5: Page 176

6.4 Changes in trading stock in s.15BA

To codify the rules on transfer pricing to require income or loss from provision between associated persons (or between parts of the same enterprise in different territories) to be computed, for tax purposes, on an arm's length basis, s.15BA was added with effect from 13 July 2018.

If trading stock is appropriated for non-trade purpose or disposed of otherwise than in the course of trade, the person is treated as having received the market value of the trading stock on the date of the appropriation or disposal, regardless of whatever amount he actually received from appropriating or disposing of the trading stock (s.15BA(2) and (4)).

If a person who carries on a trade owns an asset and it becomes trading stock of that trade or he acquires an asset as trading stock otherwise than in the course of trade, the cost of the trading stock is taken as the market value of that asset on the day it became his trading stock or on the date of acquisition, regardless of anything he gave for it to become trading stock or to acquire the trading stock (ss.15BA(3) and (5)).

However, s.15BA(4) does not apply to a disposal, and s.15BA(5) does not apply to an acquisition, of any trading stock if s.15C applies when a trade or business ceases (s.15BA(6)) (see the discussion in **section 6.5** Stock valuation on cessation of trade or business below).

'Trading stock', in relation to a trade, means anything (whether movable property or immovable property) that is sold in the ordinary course of trade; or would be so sold if it were mature or its manufacture, preparation or construction were complete; but does not include (s.15BA(1)):

- (i) Materials used in the manufacture, preparation or construction of any such thing;
- (ii) Any services performed in the ordinary course of the trade; or
- (iii) Any article produced, or any material used, in the performance of any such services.

Section 8.2 Replace ss.16(1)(g), 16(1)(ga) and add s.16(1)(gb) in the table: Page 191

Section	Allowable deductions
16(1)(g)	Capital expenditure expended for the registration of a trade mark, design, patent or plant variety right used in the production of chargeable profits.
16(1)(ga)	The payments and expenditure specified in ss.16AA, 16C, 16E, 16EA, 16F, 16G and 16I, as provided therein (discussed in section 8.6 on 'Specific deductions').
16(1)(gb)	Any deductions allowed under s.16B.

Section 8.3
Page 192

Replace ss.16(2)(e) and add s.16(2)(ab) in the table:

Section	Conditions
16(2)(ab)	Money is borrowed by a LAC banking entity by way of issuing a RCS.
16(2)(e)	Money is borrowed wholly and exclusively to finance the provision of plant and machinery (qualifying for depreciation allowance or deductible under ss.16B (for R&D activities), 16G & 16I) or the purchase of trading stock used in the production of assessable profits, and the lender is not an associate of the borrower. 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. No apportionment of the interest is allowed where the loan is not wholly applied in the manner specified above.

Section 8.3
Page 194

Under 'A summary of the seven criteria specified in s.16(2)', add s.16(2)(ab) after s.16(2)(a) in the table and change 'seven criteria' to 'eight criteria':

Section	Borrowing	Applicable to
16(2)(ab)	By special classes of business	Borrowed by a LAC banking entity by way of issuing a RCS

Section 8.5.2
Page 200

Replace the first sentence in the first paragraph with the following:

A non-Hong Kong associated corporation means an associated corporation that does not carry on any trade, profession or business in Hong Kong (s.16(3)).

Section 8.6
Page 205
to 206

Replace ss.16B and 16H – K with the following:

Section	Specific deductions
16B	Expenditure on R&D activities
16H – L	Capital expenditure on the provision of environmental protection facilities ('EPF') which include environmental protection machinery ('EPM'), environmental protection installation ('EPI') and environmental-friendly vehicles ('EFV')

A summary of the allowable deductions under ss.16A to 16L and the treatment of refund or sale proceeds of the items previously allowed as deductions are as follows:

Replace ss.16B, 16EA – EC and 16H – K with the following:

Section	Expenditure	Allowable deductions	Treatment of refund/sale proceeds
16B	Expenditure on R&D activities	Payments made, and other expenditures incurred, in relation to R&D activities	Proceeds of sale of any plant or machinery for, and rights generated from, R&D activities are treated as a trading receipt, limited to the amount of previous deduction.

Section	Expenditure	Allowable deductions	Treatment of refund/sale proceeds
16EA – EC	Purchase of specified IPRs (copyright, performer's economic right, protected layout-design (topograph) right, protected plant variety right, registered design or trade mark)	If not purchased from an associate: For registered trade mark – deductible over five successive years of assessments on a straight-line basis (subject to apportionment for non-business purpose) in the year of assessment in which the expenditure was incurred. For copyright, performer's economic right, protected layout-design (topograph) right, protected plant variety right or registered design – deductible over (i) five successive years of assessments on a straight-line basis or (ii) the number of years of the expiry period (if the expiry period is less than five years) (subject to apportionment for non-business purpose) in the year of assessment in which the expenditure was incurred.	Sale proceeds (subject to apportionment if a deduction is only allowed for part of the expenditure) of specified IPRs, to the extent that they are not otherwise chargeable to profits tax and do not exceed the amount of the deduction previously allowed, are taxable.
16H – L	Specified capital expenditure on EPI	Before 2018/19 20% per year of assessment; From 2018/19 onwards fully deductible; (subject to apportionment for non-business purpose) from the year of assessment in which the expenditure was incurred.	Sale proceeds of the EPI, to the extent that they are not otherwise chargeable to profits tax and do not exceed the amount of the deduction previously allowed, are taxable.

Section 8.6.3
Pages 209 to
210

Replace the entire section 8.6.3 with the following:

8.6.3 Expenditure on research and development activities: s.16B

Effective from 1 April 2018, s.16B was revamped to allow a deduction for payments made, and other expenditures incurred, in relation to R&D activities (s.16B(2)). The total amount of deduction is determined in accordance with Sch. 45 (s.16B(3)), and no deduction is allowed for amounts deductible apart from s.16B (s.16B(4)).

Under the new regime, R&D expenditures can generally continue to be eligible for deduction, while certain qualifying expenditures will be eligible for enhanced deduction. Allowable R&D expenditure is classified into two broad categories: Type A and Type B expenditures. The conditions for Type A and Type B expenditures deduction are summarised in the table below:

	Type A expenditure (normal deduction)	Type B expenditure (enhanced two-tiered deduction)
Rates of deduction (s.13 of Sch. 45)	100%	300% for 1st \$2m 200% for the remainder (no cap)
R&D activities (ss.2 & 4)	An ' R&D activity ', which is defined as: <ul style="list-style-type: none"> (a) An activity in the fields of natural or applied science to extend knowledge (b) An original and planned investigation carried on with the prospect of gaining new scientific or technical knowledge and understanding (c) 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 (d) 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 	A ' qualifying R&D activity ', which is defined as an R&D activity that: <ul style="list-style-type: none"> • Falls within (a) to (c); and • does not include activities that are not regarded as involving advancement in science or technology, e.g.: <ul style="list-style-type: none"> – Efficiency survey, feasibility study, management study, market research or sales promotion – Application of publicly available research findings with an anticipated outcome and without any scientific or technological uncertainty – Activity that does not seek to directly contribute to achieving an advance in science or technology by resolving scientific or technological uncertainty – Development of non-scientific or non-technological aspect of a new or substantially improved material, device, product, process, system or service
Location of R&D activities (s.4)	Undertaken in or outside HK	Wholly undertaken and carried on in HK
In-house expenditures (ss.6, 8, 10 & 12)	Expenditures on R&D activity, including capital expenditures on plant and machinery (other than Type B expenditure)	Expenditures in relation to an employee (excluding remuneration of a director) who is engaged directly and actively in a qualifying R&D activity. An employee providing supporting services (including accounting, administration, secretarial services)

	Type A expenditure (normal deduction)	Type B expenditure (enhanced two-tiered deduction)
		is not regarded as 'engaged directly and actively in a qualifying R&D activity' Expenditures on a consumable item used directly in a qualifying R&D activity. A consumable item used in supporting services (including accounting, administration, secretarial services) is not regarded as 'used directly in a qualifying R&D activity'
Outsourced payment to (s.6)	<ul style="list-style-type: none"> Designated local research institution (DLRI) University or college that is not a DLRI 	
Apportionment IF (s.12, 13)	<ul style="list-style-type: none"> R&D activity is carried on outside HK and relates to business carried on partly outside HK 	<ul style="list-style-type: none"> The employee is partly engaged directly in the R&D activity; or The consumable item is partly used directly in the R&D activity
No deduction allowed (ss.6 & 14)	<ul style="list-style-type: none"> For a payment made to an R&D institution, or an expenditure incurred, for acquiring rights generated from an R&D activity For capital expenditures on land or building If any rights generated from the R&D activity are not, or will not be, fully vested in the person; or the activity is undertaken for another person If the expenditure is or will be met directly or indirectly by a government, a public or local authority or another person If 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 a R&D deduction or a greater R&D deduction that the person would not otherwise be entitled under s.16B 	



Key terms in Schedule 45

An '**R&D expenditure**', in relation to a trade, profession or business in respect of a person chargeable to profits tax, is (s.6(1) of Sch. 45):

- (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; but does not include payments or expenditures for acquiring rights generated from an R&D activity (s.6(2) & (4)(b) of Sch. 45).

'Type A expenditure' is an R&D expenditure other than a 'Type B expenditure' (s.8(a) of Sch. 45).

'Type B expenditure' is an R&D expenditure falling within any of the following descriptions:

- (a) A payment to a DLRI for a qualifying R&D activity related to the trade, profession or business;
- (b) A payment to a DLRI 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;
- (c) A qualifying expenditure related to the trade, profession or business (s.10(1)(a) of Sch. 45).

'R&D institution' means (a) a DLRI; or (b) a university or college that is not a DLRI (s.6(5) of Sch. 45).



Example 1 (Adapted from DIPN 55, Example 4)

In developing a digital identity/know-your-client (ID/KYC) utility which involved the use of sophisticated biometric authentication techniques, Financial Institution-HK incurred in a year the following expenditures:

	\$m
Staffing costs of the research team	7
Consumable items	3
Consultancy fee paid to an independent expert	2
Testing fee	1
Total	<u>13</u>

If the development of the digital ID/KYC utility was accepted as a qualifying R&D activity, the staffing costs and the expenditures on consumable items would be eligible for enhanced deduction as Type B expenditures whereas the consultancy fee paid to the independent expert and the testing fee would be eligible for 100% deduction as Type A expenditures. Deduction that can be allowed to Financial Institution-HK for the year would be \$25 million ($(\$2m \times 300\%) + (\$10m - \$2m) \times 200\% + \$3m$).

The Commissioner for Innovation and Technology (CIT) may designate any of the following institutions as a DLRI (s.19(1) of Sch. 45):

- (a) Any university or college located in Hong Kong;
- (b) Any other local institution that undertakes qualifying R&D activities in Hong Kong.

Payments made to a local institution, which at the time of payment was not a DLRI, is eligible for the enhanced R&D tax deduction as long as the local institution is designated as a DLRI within 6 months after the date of payment (ss.6(3) and 10(3) of Sch. 45). If the local institution only becomes a DLRI in the year of assessment following the year of payment, a claim can be made for the payment even though the relevant assessment might have become final and conclusive (DIPN 55, para. 54).

If a taxpayer contracts out an R&D project to a DLRI which further subcontracts part of the project to a RI outside Hong Kong, only that part of the payment that is paid for the qualifying R&D activities carried on in Hong Kong is eligible for enhanced deduction as Type B expenditure (DIPN 55, para. 62).

'Rights' include a share or an interest in rights (s.1(2) of Sch. 45). If enterprises jointly carry on an R&D activity and the rights generated from that R&D activity are fully and jointly vested in them, the R&D expenditure incurred by each of the enterprises involved can be deducted. If any part of the rights is vested in another person who has not participated in the R&D activity, the relevant R&D expenditure cannot be deducted under s.14(a)(i) of Sch. 45 (DIPN 55, para. 83).

If a SPV acts as a nominee to hold an IP for an enterprise performing an R&D activity, the rights generated from the R&D activity would be regarded as fully vested in the enterprise (DIPN 55, para. 84).

R&D expenditures incurred by an enterprise within a group on a R&D activity undertaken for its associates (another person) is not deductible (s.14(a)(ii) of Sch. 45). However, if the IP generated from the R&D activity is held by the enterprise as the 'economic owner' for use by its associates on payment of a royalty fee, the R&D activity carried on by the enterprise would not be regarded as undertaken for the associate and the enterprise may still be able to claim a deduction (DIPN 55, para. 85).

R&D expenditure incurred before a trade, profession or business commences is treated as if it had been incurred on the first day of commencement (s.7(2) of Sch. 45).

An R&D expenditure may only be deducted for one trade, profession or business (s.15 of Sch. 45).

If cash rebate or reimbursement of R&D expenditure is received after the enterprise has been granted deduction of such expenditure, the enterprise should notify the Commissioner within a reasonable time. Additional assessment would be raised to disallow deduction of the R&D expenditure concerned. Failure to notify the Commissioner of any reimbursement or cash rebate received may result in penal actions (DIPN 55, para. 99).

The Commissioner may seek advice from the CIT to ascertain if (s.18 of Sch. 45):

- (a) An activity falls within the scope of R&D activities qualifying for the tax deduction;
- (b) The expenditure should be regarded as incurred in relation to an R&D activity qualifying for the tax deduction.

Proceeds of sale of any plant or machinery for, and rights generated from, R&D activities will be treated as a trading receipt, limited to the amount of previous deduction (s.16B(5), ss.16 and 17 of Sch. 45). A sale occurs at the time of its completion or the time when possession of the plant or machinery is given, whichever happens earlier. If the sale occurs on or after the date of cessation of business, it is deemed to accrue immediately before cessation. If plant or machinery is destroyed, it is to be treated as if it had been sold before its destruction and any insurance moneys or other compensation immediately and money received are treated as if they were the sale proceeds.

If the expenditures deducted for the R&D activities that generated the rights (underlying activities) consist of solely Type A expenditures or Type B expenditures, the specified amount deemed as a trading receipt would be the lesser of the total amount of deductions allowed under s.16B for the expenditures and the sale proceeds of the rights (s.17(4)(b) of Sch. 45).

If the expenditures deducted for the underlying activities consist of both Type A expenditures and Type B expenditures, the specified amount would be calculated in accordance with the following steps (ss.17(4)(a) and (7) of Sch. 45):

Step 1:

Divide sale proceeds 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.

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.

If any relevant Type A expenditure for the underlying activities was not allowed to be deducted in full, the sale proceeds are to be adjusted downward. The adjusted sale proceeds are to bear the same ratio to sale proceeds A as the ratio that the total amount of deduction(s) allowed for all Type A expenditures for the underlying activities bears to those Type A expenditures (s.17(7) of Sch. 45). In other words, the sale proceeds will be restricted to such part as proportionate to the extent of the deductible proportion of Type A expenditures. The amount assessable shall not exceed the amount of deduction previously allowed (DIPN 55, para. 110).

**Example 2 (Adapted from DIPN 55, Example 19)**

Enterprise-HK carried on its trade partly in Hong Kong and partly outside Hong Kong. In Year 1, Enterprise-HK undertook an R&D project where part of the R&D work was performed outside Hong Kong. In respect of such overseas R&D activity, Enterprise-HK incurred Type A expenditure of \$1 million. For the qualifying R&D activity carried on in Hong Kong, Enterprise-HK incurred Type B expenditure of \$5 million. Enterprise-HK claimed that half of its profits were derived outside Hong Kong for Year 1. Enterprise-HK was allowed deduction of the following amount under s.16B:

R&D expenditure	Amount incurred	Deduction allowed
	\$m	\$m
Type A expenditure	1	0.5 ¹
Type B expenditure	<u>5</u>	<u>12.0</u> ²
Total	<u>6</u>	<u>12.5</u>

Note 1: $\$1\text{m} \div 2$ (per s.13(3) of Sch. 45)

Note 2: $\$2\text{m} \times 300\% + \$3\text{m} \times 200\%$

In Year 3, the patent generated from the R&D project was sold for \$12 million.

The sale proceeds of the patent, treated as a trading receipt under s.17 of Sch. 45, would be calculated as follows:

Step 1: Sale proceeds A = $\$12\text{m} \times 1 \div 6 = \2m

Sale proceeds B = $\$12\text{m} \times 5 \div 6 = \10m

Step 2: Adjusted sale proceeds A = $\$2\text{m} \times 0.5 \div 1 = \1m

As the amount of deduction for Type A expenditure is less than adjusted sale proceeds A, amount A = \$0.5m.

Step 3: As sale proceeds B is less than total amount of deduction for Type B expenditure, amount B = \$10m.

Step 4: Specified amount = \$0.5m + \$10m = \$10.5m

Thus, the taxable amount of the sale proceeds would be \$10.5 million.

DIPN 55 provides guidance on profits tax deductions for expenditures on R&D activities.

Example 68
Page 212

In part (a) of the solution, under alternative 2, revise the tax rate of 16.5% to 8.25%, the profits tax payable of \$39,600 to \$19,800, and \$24,750 to \$12,375.

In part (b) of the solution, revise the tax rate from 16.5% to 8.25%, the profits tax payable of \$132,000 to \$66,000, and \$82,500 to \$41,250.

Section 8.6.7
Page 213

Replace the heading and the first paragraph under section 8.6.7 with the following:

8.6.7 Purchase and sale of specified intellectual property rights: s.16EA

The s.16E relief does not apply to acquisitions of trade marks or other IPRs. To promote wider application of IPRs by local enterprises and to facilitate the development of creative industries in Hong Kong, s.16EA was enacted to extend the scope of deduction to cover registered trade marks, copyrights and registered designs (collectively referred to as '**specified IPRs**') as from the year of assessment 2011/12. The scope of deduction was further extended to cover performer's economic right, protected layout design (topography) right and protected plant variety right as from 29 June 2018.

Section 8.6.7
Page 214



In the Key terms in s.16EA(11), add the following terms after 'Copyright':

'Performer's economic right' means a right mentioned in s.215(1)(a), (b), (c) or (d) of the Copyright Ordinance and conferred by Part III of that Ordinance on a performer; or a right that corresponds to the right mentioned in paragraph (a) and subsists under the law of a place outside Hong Kong.

'Protected layout design (topography) right' means a right in a layout-design (topography) that is protected under s.3 of the Layout-design (Topography) of Integrated Circuits Ordinance; or a right that corresponds to the right mentioned in paragraph (a) and subsists under the law of a place outside Hong Kong.

'Protected plant variety right' means a right granted under Part III of the Plant Varieties Protection Ordinance; or a right that corresponds to the right mentioned in paragraph (a) and subsists under the law of a place outside Hong Kong.

And replace 'Specified intellectual property right' by the following:

'Specified intellectual property right' means a copyright, performer's economic right, protected layout-design (topography) right, protected plant variety right, registered design or registered trade mark.

Under 'Tax deduction rules':

Add paragraphs (d), (e) and (f), and rename paragraph (d) as (g):

(d) In the case of a performer's economic right, the right has not expired (s.16EA(6)(ba)).

(e) In the case of a protected layout-design (topography) right, the protection of the layout-design has not ceased (s.16EA(6)(bb)).

(f) In the case of a protected plant variety right, the grant of the protected plant variety right is in force (s.16EA(6)(bc)).

Replace the fourth paragraph with the following:

However, where the maximum period of protection for copyright, performer's economic right, protected layout-design (topography) right, protected plant variety right or registered design expires within the five-year deduction period, tax deductions will be claimed in equal instalments over the remaining years of protection (s.16E(4)). As legal protection of trade mark could be perpetual, tax deductions for trade mark will not be spread over a period of shorter than five years.

**Section 8.6.8
Page 217**

Replace the first paragraph with the following:

S.16EA extends the scope of deductions to cover specified IPRs, effective from the year of assessment 2011/12. The law however contains several anti-avoidance provisions which deny tax deductions for patent rights or rights to know-how, copyright, designs and trade marks, and effective from 29 June 2018, performer's economic right, protected layout-design (topography) right and protected plant variety right (collectively referred to as the '**relevant rights**') when:

**Section
8.6.11
Page 224**

Under 'Tax deduction rules', replace the fourth paragraph with the following paragraphs:

Specified capital expenditure incurred on the construction of EPI is, prior to 2018/19, deductible in five equal yearly instalments (i.e. 20% per year of assessment), as long as the installation has not been sold at the end of the basis period (s.16I(3)). However, effective from 2018/19, expenditure incurred in a year of assessment is wholly deductible in that year.

Where a deduction for the expenditure is allowed, the taxpayer is not entitled to any depreciation allowance (s.16I(5)).

Specified capital expenditure incurred before a trade, profession or business commenced is treated as if it had been incurred on the first day of commencement (s.16I(6)).

**Section
8.6.11
Page 225**

Under 'Taxation of proceeds from the sale of EPFs', replace the second paragraph with the following two paragraphs:

If an **EPI purchased before 1 April 2018** is subsequently sold, the excess of sale proceeds over any unallowed amount, if any, is treated as a taxable trading receipt (limited to the amount of the deduction) at the time of the sale. If the sale occurs on or after the permanent discontinuance of the trade, profession or business, it is deemed to occur immediately before discontinuance (ss.16J(3)(b) and (c)). However, if the unallowed amount exceeds the sale proceeds, the excess is deductible in the basis period for which the sale occurs (s.16J(3)(a)).

If an **EPI purchased on or after 1 April 2018** is subsequently sold, the sale proceeds is treated as a taxable trading receipt (limited to the amount of the deduction) at the time of the sale. If the sale occurs on or after the permanent discontinuance of the trade, profession or business, it is deemed to occur immediately before discontinuance (ss.16J(3A) and (3B)).

Add the following paragraph before the last paragraph:

If an EPM or EPI is destroyed, or an EPV is destroyed or stolen, it is deemed to have been sold immediately before it was destroyed or stolen, and the insurance money, other compensation and any money derived from the remains are treated as sale proceeds (ss.16J(5) and (5A)).

Section 9.2.1 Page 233	<p>Under Key terms, revise paragraph (f) as follows:</p> <p>(f) For the purposes of R&D activities within the meaning of s.2 of Sch. 45 related to any trade, profession or business.</p>																																							
Section 9.4 Page 243	<p>Replace the third paragraph with the following:</p> <p>Capital expenditure on machinery or plant used for R&D activities is allowed as a deduction under s.16B(2) (see section 8.6.3 on 'Expenditure on research and development activities: s.16B').</p>																																							
Section 9.4.3 Page 245	<p>Revise paragraph (b) as follows:</p> <p>(b) Excludes expenditure which is reimbursed by way of or is attributable to any grant, subsidy or similar financial assistance, and those allowed under ss.16B(2), 16G and 16I(2), (3), (3A) and (3B), and those on implements, utensils and articles.</p>																																							
Section 9.4.4 Page 246	<p>Replace 'Annual allowance under s.39B(2)' with the following:</p> <p>Annual allowance is given at the appropriate rate (10%, 20% or 30%) on the 'reducing value' of the pool, which is ascertained as follows:</p> <table border="0" style="width: 100%;"> <tr> <td style="width: 80%;">Opening reducing value ('RV') (written down value 'WDV') b/f</td> <td style="width: 10%;"></td> <td style="width: 10%; text-align: right;">A</td> </tr> <tr> <td>Add: Additions</td> <td style="text-align: right;">B1</td> <td></td> </tr> <tr> <td> Less: Initial allowance</td> <td style="text-align: right;"><u>(B2)</u></td> <td style="text-align: right;">B</td> </tr> <tr> <td> Hire-purchased assets (RV) (ownership passed in the preceding year)</td> <td></td> <td style="text-align: right;">C</td> </tr> <tr> <td> Private assets brought into business use (actual cost less notional allowance under s.39B(6))</td> <td></td> <td style="text-align: right;">D</td> </tr> <tr> <td> Aircraft owned and used for a qualifying aircraft leasing activity brought into another business (actual cost less notional allowance under s.39B(6A) & (6B))</td> <td></td> <td style="text-align: right;">E</td> </tr> <tr> <td> Succeeded assets (RV under s.39B(7))</td> <td></td> <td style="text-align: right;"><u>F</u></td> </tr> <tr> <td></td> <td></td> <td style="text-align: right;"><u>G</u></td> </tr> <tr> <td>Less: Sale, insurance, salvage or compensation moneys (limited to cost/deemed cost)</td> <td></td> <td style="text-align: right;">(H)</td> </tr> <tr> <td> Assets taken from the pool for private use (market value)</td> <td></td> <td style="text-align: right;"><u>(I)</u></td> </tr> <tr> <td>RV (WDV) before annual allowance</td> <td></td> <td style="text-align: right;">J</td> </tr> <tr> <td>Less: Annual allowance (10%, 20% or 30% on J)</td> <td></td> <td style="text-align: right;"><u>(K)</u></td> </tr> <tr> <td>Closing RV (WDV) c/f</td> <td></td> <td style="text-align: right;"><u><u>L</u></u></td> </tr> </table>	Opening reducing value ('RV') (written down value 'WDV') b/f		A	Add: Additions	B1		Less: Initial allowance	<u>(B2)</u>	B	Hire-purchased assets (RV) (ownership passed in the preceding year)		C	Private assets brought into business use (actual cost less notional allowance under s.39B(6))		D	Aircraft owned and used for a qualifying aircraft leasing activity brought into another business (actual cost less notional allowance under s.39B(6A) & (6B))		E	Succeeded assets (RV under s.39B(7))		<u>F</u>			<u>G</u>	Less: Sale, insurance, salvage or compensation moneys (limited to cost/deemed cost)		(H)	Assets taken from the pool for private use (market value)		<u>(I)</u>	RV (WDV) before annual allowance		J	Less: Annual allowance (10%, 20% or 30% on J)		<u>(K)</u>	Closing RV (WDV) c/f		<u><u>L</u></u>
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Closing RV (WDV) c/f		<u><u>L</u></u>																																						
New section 9.4.9 Page 250	<p>Add a new section 9.4.9 and a new example 92a after section 9.4.8:</p> <p>9.4.9 Aircraft subsequently used in another trade, profession or business to produce chargeable profits: ss.37(2B)–(2D) and ss.39B(6A)–(6C)</p> <p>When an aircraft previously owned and used by a corporation for carrying out a qualifying aircraft leasing activity is subsequently used by the corporation in another trade, profession or business to produce chargeable profits, no initial allowance is granted as no capital expenditure is incurred. Annual allowance is to be computed based on the deemed cost of the aircraft. The deemed cost is computed by deducting from the actual cost of the aircraft the notional annual allowances for the period during which the aircraft was owned and used by the corporation for carrying out a qualifying aircraft leasing activity in respect of which the half rate concession applies, as if such annual allowances had been available to the corporation since it acquired the aircraft.</p>																																							



Example 92a (Adapted from DIPN 54, Example 11)

Qualifying Aircraft Lessor-HK acquired an aircraft at a consideration of \$300 million and used it for carrying out a qualifying aircraft leasing activity in Year 1 and Year 2 where half-rate concession was granted. In Year 3, Qualifying Aircraft Lessor-HK ceased the aircraft leasing business and became dormant. In Year 4, it started an air transportation business and used the aircraft for such purpose.

S.39B(6B) would apply since the aircraft has been used by Qualifying Aircraft Lessor-HK for carrying out a qualifying aircraft leasing activity in respect of which the half rate concession applied before being used in the air transportation business.

Therefore, depreciation allowances of the aircraft for Year 4 would be computed as follows:

	\$
Acquisition cost	300,000,000
Less: Notional AA for Year 1	90,000,000
	<u>210,000,000</u>
Less: Notional AA for Year 2	63,000,000
	<u>147,000,000</u>
Less: Notional AA for Year 3	44,100,000
	<u>102,900,000</u>
Less: AA for Year 4	30,870,000
	<u><u>72,030,000</u></u>

Original
section 9.4.9
Page 250

Renumber section 9.4.9 'Assets removed from the pool for non-business use: s.39C(3)' as section 9.4.10.

Original
section 9.4.10
Page 250

Renumber section 9.4.10 'Miscellaneous provisions' as section 9.4.11.

Original
section 9.4.11
Page 255

Renumber section 9.4.11 'Assets used in the Mainland by cross-border processing businesses' as section 9.4.12.

New section
10.4
Page 265

Add a new section 10.4 before section 11 'Basis Period':

10.4 Fair Value Accounting for financial instruments under ss.18G to 18L

The prevailing accounting standards (HKFRS 9) require entities in Hong Kong to account for financial instruments on a fair value (FV) basis with the revaluation gains or losses reported as income or losses in the year they arise (the 'FV basis'). In *Nice Cheer Investment Ltd v CIR* ('*Nice Cheer*'), the CFA ruled that these accounting treatments should not be followed for taxation purposes. Unrealised revaluation gains are not taxable at the time they are accounted for, while unrealised revaluation losses may be deductible at the time of recognition in limited circumstances (the 'realisation basis') (see the discussion in **section 6.3.4** on doubt on the application of *Sharkey v Wernher* principle).

In view of the substantial costs and practical difficulties in re-computing profits or losses in respect of financial instruments on a realisation basis, as an interim administrative measure, since 2013/14 taxpayers are allowed to choose to use either the FV basis or realisation basis for profits tax filing purposes.

To codify this interim administrative measure, Inland Revenue (Amendment) (No. 2) Ordinance 2019 was passed on 1 March 2019 to enact new ss.18G to 18L that apply to a year of assessment for which the basis period begins on or after 1 January 2018. The new provisions allow taxpayers to elect and align the tax treatments of financial instruments with their accounting treatments.

Upon election in writing, taxpayers can compute the assessable profits or allowable losses based on the amounts recognised in the profit or loss account. Accounting profits or losses so recognised, regardless of whether they are realised or unrealised, would generally be taxable or deductible, provided that they are revenue and onshore in nature. This principle applies to a financial instrument measured at:

- (i) FV through profit or loss (s.18J(4));
- (ii) Amortised cost; or
- (iii) FV through other comprehensive income (s.18J(5)).

However, special treatments apply to a number of exceptional items, such as a debt security with an embedded derivative (s.18L), an impairment loss of a debt instrument (s.18K) and a non-arm's length loan/debt (s.18L), where the tax treatments do not follow the accounting treatments.

The election made has effect for the year and all subsequent years of assessment, and is irrevocable (s.18H(2)(a) and (b)). However, taxpayers may apply in writing to the Commissioner to revoke the election if he can prove that there are good commercial reasons, and tax avoidance is not the main purpose, or one of the main purposes for the revocation (s.18H(4) and (5)).

Section 12.1
Page 272

Replace the second paragraph with the following:

Although a partnership is not a legal person, it is a taxable entity for tax purposes. Tax is imposed on the share of profits of a corporate partner at the two-tiered tax rates of 8.25% and 16.5% (16.5% up to and including the year of assessment 2017/18), and on the balance of the profits at the two-tiered tax rates of 7.5% and 15% (15% up to and including the year of assessment 2017/18).

Section 12.3
Page 273

Replace paragraph (b) with the following:

- (b) When there is a corporate partner, its share of profit is subject to the two-tiered tax rates of 8.25% and 16.5% (16.5% up to and including the year of assessment 2017/18).

Section 13.6
Page 280

Under section 13.6 'Unabsorbed loss from normal and concessionary trading receipts', replace the two paragraphs with the following paragraphs:

Sections 19CA and 19CB provide for the cross set off of unabsorbed losses from profits taxed at the normal rates and profits taxed at the concessionary rates specified in s.14A (i.e. QDIs), s.14B (i.e. qualifying reinsurance business of a professional reinsurer and qualifying insurance business of an authorised captive insurer), s.14D (i.e. qualifying profits of a CTC), s.14H (i.e. qualifying profits derived from qualifying aircraft leasing activity carried on by a qualifying aircraft lessor), or s.14J (i.e. qualifying profits derived from qualifying aircraft leasing management activity carried on by a qualifying aircraft leasing manager). For this purpose, profits or loss derived from normal trading receipts ('NTR') are referred to as 'normal profits or loss', and profits or loss derived from concessionary trading receipts ('CTR') are referred to as 'concessionary profits or loss'.

As these five streams of profits are taxed at different rates, it is necessary to apply an adjustment factor ('AF') to the profits or loss to be set off. The adjustment factor is the ratio the concessionary tax rates bear to the normal tax rates, which is 2 (i.e. 8.25%/16.5% for corporations; 7.5%/15% for persons other than corporations).

Section 14
Page 282

Replace 15(1)(i) and (l), 17A – 17G and add s.26AB in the table:

Section	Special classes of business
15(1)(i), (ib), (l) and (lb), 17A – 17G	FIs
26AB	Threshold requirements relating to concession condition provisions

Section 14.1.1
Page 283

Replace 'ss.15(1)(i) and (l)' in the first two paragraphs with 'ss.15(1)(i), (ib), (l) and (lb)'.

Section 14.3.1
& 14.3.2
Page 291 to
293

Delete 14.3.1 'Qualifying business of reinsurance of offshore risks' and 14.3.2 'Qualifying business of insurance of offshore risks'.

Add a new section 14.3.1.

14.3.1 Qualifying reinsurance and captive insurance business: s.14B(1)

Pursuant to s.14B(1)(a) and (b), the assessable profits of a corporation derived from the business of (i) reinsurance as a professional reinsurer, or (ii) insurance as an authorised captive insurer, will be taxed at one-half of the rate specified in Sch. 8, where the following two conditions are satisfied:

- (a) The activities that produce the assessable profits are carried out in Hong Kong by the corporation, or arranged by it to be carried out in Hong Kong (s.14B(2)(a)). For this purpose, from the year of assessment 2018/19, the Commissioner may prescribe thresholds for determining whether these conditions have been met (s.26AB). These thresholds may stipulate the number of full-time employees in Hong Kong who carry out these activities, including their qualifications, and the amount of operating expenditure incurred in Hong Kong for the activities. Failure to comply with these thresholds will result in the corporation being taxed at the full profits tax rate. No thresholds have yet been prescribed.
- (b) The corporation has elected in writing to be subject to the concessional tax rate for the relevant year of assessment. Such election is irrevocable with respect to that year of assessment (s.14B(2)(b) and (3)).

To prevent a person claiming a tax deduction worth 16.5% for a payment made to a connected reinsurer or captive insurer which is taxed at the concessional 8.25% rate, the deduction available to the payer is reduced by one-half (s.16(1A)).



Key terms in s.14B(4)

'Professional reinsurer' means a company authorised under s.8 of the Insurance Ordinance to carry on in or from Hong Kong reinsurance business only.

'Authorised captive insurer' means a company that:

- (a) Is a captive insurer as defined by s.2(7)(a) of the Insurance Ordinance; and
- (b) Is authorised under s.8 of that Ordinance to carry on in or from Hong Kong insurance business as such a captive insurer.

Section 14.3.3 Renumber 14.3.3 as 14.3.2.
Page 293

Section 14.5.1 Add the following paragraph after 'Exempt sums':
Page 296

From the year of assessment 2018/19, a sum will be treated as an 'exempt sum' only if the taxpayer's activities that produce that sum are carried out by the taxpayer in Hong Kong, or arranged by the taxpayer to be carried out in Hong Kong (s.23B(4AA)). For this purpose, the Commissioner may prescribe thresholds for determining whether these conditions have been met (s.26AB). These thresholds may stipulate the number of full-time employees in Hong Kong who carry out these activities, including their qualifications, and the amount of operating expenditure incurred in Hong Kong for the activities. Failure to comply with these thresholds will result in the sum not being exempted, and included in the taxable 'relevant sum'. No thresholds have yet been prescribed.

Section 14.5.3 Under section 14.5.3 'Double tax arrangements with other countries', replace the first two paragraphs with the following:
Page 300

In November 2003, there was another DTA (Airline and Shipping Income Agreements) on shipping and air services income with Singapore. A similar agreement with Sri Lanka was entered into in November 2004. There are also six DTAs (Shipping Income Agreements) on shipping income with Denmark, Germany, the Netherlands, Norway, the United Kingdom and USA on international shipping income. Shipping income chargeable to Hong Kong profits tax by virtue of s.23B(2) are exempted if the owners are residents of Korea or New Zealand, and vice versa.

The Avoidance of Double Taxation on shipping services income is also covered by the comprehensive DTAs signed by the Hong Kong Government. As of 1 June 2019, Hong Kong has concluded comprehensive DTAs with 40 jurisdictions including Austria, Belarus, Belgium, Brunei, Canada, the Czech Republic, Finland, France, Guernsey, Hungary, India, Indonesia, Ireland, Italy, Japan, Jersey, Korea, Kuwait, Latvia, Liechtenstein, Luxembourg, the mainland of China, Malaysia, Malta, Mexico, the Netherlands, New Zealand, Pakistan, Portugal, Qatar, Romania, Russia, Saudi Arabia, South Africa, Spain, Switzerland, Thailand, the United Arab Emirates, the United Kingdom and Vietnam.

Section 14.6.2 Under section 14.6.2 'Double tax arrangements on international aviation income', replace the last paragraph with the following:
Page 305

The Avoidance of Double Taxation on air services income is also covered by the comprehensive DTAs signed by the Hong Kong Government. As of 1 June 2019, Hong Kong has concluded comprehensive DTAs with 40 jurisdictions including Austria, Belarus, Belgium, Brunei, Canada, the Czech Republic, Finland, France, Guernsey, Hungary, India, Indonesia, Ireland, Italy, Japan, Jersey, Korea, Kuwait, Latvia, Liechtenstein, Luxembourg, the mainland of China, Malaysia, Malta, Mexico, the Netherlands, New Zealand, Pakistan, Portugal, Qatar, Romania, Russia, Saudi Arabia, South Africa, Spain, Switzerland, Thailand, the United Arab Emirates, the United Kingdom and Vietnam. For details, refer to Chapter 12 '**Double Taxation Arrangements and Agreements**'.

List of provisions relating to sums specifically chargeable to profits tax

Section	Sums specifically chargeable to profits tax
15(1)(b)	Replace the paragraph with the following: Sums received by or accrued to a person for the use, or the right to the use, in Hong Kong of any patent, design, trade mark, copyright material, layout-design (topography) of an integrated circuit, performer's right, plant variety right, secret process or formula, or other similar property or right; or for imparting knowledge connected with the use in Hong Kong of any such properties.
16B(3) changed to 16B(5)	Replace the paragraph with the following: Proceeds from sale of any plant or machinery for, and rights generated from, R&D activities previously allowed as a deduction under s.16B(2). The taxable amount is limited to the amount of the deduction.
16J(3) changed to 16J(3), (3A) and (5)	Replace the paragraph with the following: Proceeds from sale of an EPI previously allowed as a deduction under s.16I(3), (3A) and (3B) that exceeds the unallowed amount (if any). The taxable amount is limited to the amount of the deduction.

And add the following sections in the table:

Section	Sums specifically chargeable to profits tax
15(1)(bb)	Sums received by or accrued to a performer or an organiser for an assignment of, or an agreement to assign, a performer's right in relation to a performance given by the performer in Hong Kong on or after 29 February 2018.
15(1)(bc)	Sums received by or accrued to a person for the use, or the right to the use, outside Hong Kong of any intellectual property (IP) or know-how generated from any R&D activity which is deductible under s.16B in ascertaining profits of the person under profits tax; or for imparting knowledge connected with the use outside Hong Kong of any such IP or know-how.
15(1)(ib)	Sums received by or accrued to a LAC banking entity by way of interest in respect of a regulatory capital security that arises through or from the carrying on of its business in Hong Kong, even if the moneys laid out for the acquisition of the security in respect of which the interest is received or accrues are made available outside Hong Kong.
15(1)(lb)	Sums received by or accrued to a LAC banking entity by way of gains or profits that arises through or from the carrying on of its business in Hong Kong from the sale or disposal, or on the redemption on maturity or presentment of a regulatory capital security, even if (i) the moneys laid out for the acquisition of the security were made available outside Hong Kong; or (ii) the sale, disposal or redemption is effected outside Hong Kong.

Section	Sums specifically chargeable to profits tax
15(1)(n)	Sums received by or accrued to a corporation by way of gains or profits (other than those arising from the sale of capital assets) arising through or from the carrying on in Hong Kong by the corporation of: <ul style="list-style-type: none"> (i) Its business of granting a right to use an aircraft to another person (aircraft business), even if the aircraft is used outside Hong Kong; or (ii) Its business of managing a corporation carrying on an aircraft business or of managing an aircraft business, even if the aircraft concerned is used outside Hong Kong.

Appendix 21
Page 365

List of provisions relating to sums specifically chargeable to profits tax

Add the following sections in the table:

Section	Sums specifically exempt from profits tax
14A(1B)	Sums received by or accrued to a person as interest paid or payable on a debt instrument on or after 1 April 2018, and any gain or profit on the sale or other disposal, or on the redemption on maturity or presentment, of the debt instrument.
26A(1)(ca) and (cb)	Additional payments on and profit on sale or other disposal of, or on redemption on maturity of, an alternative bond issued in connection with a borrowing by the Government under the Loans Ordinance.

Appendix 22
Page 367

List of provisions relating to allowable deductions

Revise ss.16(1)(ga), 16EA – EC, 16H – K and add s.16(1)(gb) to the following sections in the table:

Section	Allowable deductions	Conditions
16(1)(ga)	Payments and expenditure specified in ss.16AA, 16C, 16E, 16EA, 16F, 16G and 16I	As prescribed in ss.16AA, 16C, 16E, 16EA, 16F, 16G and 16I
16(1)(gb)	Expenditures on R&D activities	As prescribed in Sch. 45
16B	Expenditures on R&D activities, including expenditures on machinery or plant	Payments made to designated local research institutions for qualifying R&D activities and expenditures incurred for in-house qualifying R&D activities
16EA – EC	Purchase of design, trade mark, copyright material, layout-design (topography) of an integrated circuit, performer's right, plant variety right, secret process or formula specified intellectual property rights	Used in Hong Kong in the production of assessable profits Not purchased from an associate Allowable by five equal instalments (20% per year of assessment) Apportionment is required if used partly for non-business purpose

	Section	Allowable deductions	Conditions
	16H – L	Capital expenditures on the provision of EPI	Not otherwise deductible No depreciation allowance has been claimed Not being a leased asset or an asset under a hire-purchase agreement Up to 2017/18, allowable by five equal instalments; with effect from 2018/19, 100% deductible Apportionment is required if used partly for non-business purpose
Topic recap Page 372	In item 5, add s.20AH to the list of 'Certain sums are specifically exempt from profits tax'; and add ss.14H and 14J to the list of 'Concessionary trading receipts chargeable at half of the tax rate'.		
Topic recap Page 373	Under 'Deductions' – 'specific': (a) Change ss.16(2)(a)-(g), (2A), (2B), (2C), (2CA) and (2CC) to ss.16(2)(a)-(g), (2AA), (2AAB), (2A), (2B), (2C), (2CA), (2CB) and (2CC). (b) Change ss.16A, 16AA, 16B-E, 16EA-EC, 16F-K to ss.16A, 16AA, 16B-E, 16EA-EC, 16F-L.		
Topic recap Page 375	Under 'Partnerships', replace '16.5% on share of profits of corporate partner' with '8.25% or 16.5% on share of profits of corporate partner', and 'Standard rate on balance of profits' with '7.5% or 15% on balance of profits'.		
Further reading Page 402	Add 'DIPN 54 Taxation of Aircraft Leasing Activities' and 'DIPN 55 Deduction for Research and Development Expenditure' at the end of the list of primary references.		
Answers to exam practice questions Pages 927 and 928	New Happy Inn – under part (e), replace the first sentence of the last paragraph with the following: By virtue of ss.15(1)(b) and 21A, J Co will therefore be subject to profits tax on 30% of the royalty income earned during the year under review, at 8.25% (for the first \$2 million profits) and 16.5% (for profits over \$2 million).		
Chapter 4 Non-resident persons			
Topic list Page 403	Delete 2.7 Business with closely connected resident persons Add 'and open-ended fund companies' to the end of topic 3 Add 3.3 Exemption provisions for funds and open-ended fund companies Renumber 3.3 as 3.4.		

**Section 1
Page 405** Under Topic highlights, replace the last sentence in the first paragraph with the following:

There are no definitions for 'residents' and 'non-residents' under the IRO except in the case of aircraft owners (see ss.23C and 23D), offshore funds, offshore private equity funds and open-ended fund companies (see ss.20AB(2) and (3)).

**Section 2
Page 405** Under Topic highlights, delete section 15 (1)(a), (b), (ba), and (d), section 20 and replace and add the following sections in the table:

Section	Scope
15(1)(a), (b), (ba), (bb) and (d)	Deemed trading receipts
20AM to 20AY	Exemption for funds and open-ended fund companies

**Section 2.2.1
Page 407** Replace and add the following sections in the table:

Section	Scope
15(1)(b)	Sums, not otherwise chargeable to profits tax, received by or accrued to a person for the use of or right to use in Hong Kong any patent, design, trade mark, copyright material, layout-design (topography) of an integrated circuit, performer's right, plant variety right, secret process or formula or other similar property, or for imparting knowledge connected with the use in Hong Kong of any such properties.
15(1)(bb)	Sums received by or accrued to a performer or an organiser for an assignment of, or an agreement to assign, a performer's right in relation to a performance given by the performer in Hong Kong on or after 29 February 2018.

**Section 2.2.3
Example 1
Page 409** Replace the last two paragraphs with the following:

If the deemed profit is 30% of the payment, A Ltd and B Ltd as a whole will enjoy a tax benefit of \$57,750 ($\$1m \times 8.25\% - \$1m \times 30\% \times 8.25\% = \$57,750$).

If the deemed profit is 100% of the payment, A Ltd and B Ltd as a whole will get no tax benefit from the arrangement ($\$1m \times 8.25\% - \$1m \times 100\% \times 8.25\% = \text{Nil}$).

**Section 2.4
Page 409** Replace paragraph (a) with the following:

Sums chargeable under ss.15(1)(a), (b), (ba) or (bb);

**Section 2.4
Page 410** Replace the table with the following:

Situation	Tax to be withheld on behalf on a non-resident person
Sums taxable under ss.15(1)(a), (b), (ba) or (bb)	7.5%/15% or 8.25%/16.5% on 30% or 100% of the sums (s.21A)
Sums payable for the performance of a non-resident sportsman or entertainer in connection with a commercial occasion or event	7.5%/15% on 2/3 of the sum (s.21)*

Section 2.7 **Delete the entire 2.7 Business with closely connected resident persons**
Page 414 to
416

Section 3.1 **3.1 Exemption provisions for offshore funds**
Page 417

Under key terms, add (g) to the list of 'specified transactions':

- (g) A transaction in an investee company's shares carried out through or arranged by a specified person for, or carried out by, a non-resident partner fund.

Add a new section 3.3 and renumber the original section 3.3 as 3.4:

New section **3.3 Exemption provision for funds and open-ended fund**
3.3 **companies**
Page 431

On 20 February 2019, the legislative bill which granted profits tax exemption to all privately-offered funds was passed by the Legislative Council. The new unified exemption regime will be effective for transactions occurring on or after 1 April 2019, and contains two exemptions from profits tax:

- (a) An exemption for funds that meet certain qualifying criteria; and
(b) An exemption for 'special purpose entities' established by a qualifying fund.

The exemption combines separate exemptions for non-resident persons (including offshore funds) and an exemption for open-ended fund companies ('OFCs') incorporated in Hong Kong. The existing exemption for offshore funds continues to apply for any entities that do not satisfy the qualifying criteria for the new funds exemption.

3.3.1 Exemption for funds and open-ended fund companies

S.20AN(2) provides that where the condition in s.20AN(3) is met, a fund is exempt from profits tax in Hong Kong in respect of its assessable profits from:

- (a) Transactions in assets of a class specified in Sch. 16C ('qualifying transactions');
(b) Transactions incidental to the carrying out of qualifying transactions ('incidental transactions'), provided that the trading receipts from the incidental transactions do not exceed 5% of the total trading receipts from both the qualifying transactions and incidental transactions (s.20AN(4)); and
(c) Transactions in assets of a non-Schedule 16C class if the fund is an OFC.

The condition in s.20AN(3) is:

- (i) The qualifying transactions of the fund are carried out in Hong Kong by or through a specified person; or arranged in Hong Kong by a specified person; or
(ii) The fund is a qualified investment fund.

Classes of assets specified in Sch. 16C are securities; shares of, or debentures issued by, a private company; futures contracts; foreign exchange contracts; deposits other than those made by way of a money-lending business; deposits made with a bank; certificates of deposit; exchange-traded commodities; foreign currencies; OTC derivative products; and an investee company's shares co-invested by a partner fund and ITVFC under the ITVF Scheme.

'Specified person' means a corporation licensed under Part V of the SFO to carry on, or an authorised financial institution registered under that Part V for carrying on, a business in any regulated activity as defined by Part 1 of Sch. 5 to the SFO (s.20AN(6)).

'Qualified investment fund' in s.20AN(6) means a fund in relation to which

- (a) at all times after the final closing of sale of interest
 - (i) the number of investors exceeds 4; and
 - (ii) the capital commitments made by investors exceed 90% of the aggregate capital commitments; and
- (b) an agreement governing the operation of the fund provides that not more than 30% of the net proceeds arising out of the transactions of the fund are to be received by the originator and the originator's associates, after deducting the portion attributable to their capital contributions (which is proportionate to that attributable to the investors' capital contributions).

3.3.2 Exemption for a special purpose entity established by a qualifying fund

Certain funds may establish a special purpose entity ('SPE') for holding, directly or indirectly, one or more investee private companies. If the fund qualifies for exemption, the SPE is also exempt in respect of its profits derived from the disposal of an interposed SPE or investee private companies, to the extent that corresponds to the percentage of shares or interests held by the exempt fund (s.20AO(2) and (3)).

While exemption will apply at both the fund and SPE level, the permitted scope of activities that a SPE can undertake is more restrictive than that of a fund. The only role that can be played by a SPE is limited to holding and administering investee private companies, and is prohibited from making investment in any other qualifying assets.

'Investee private company', in relation to a fund, means a private company held by a SPE or an interposed SPE as a shareholder on behalf of the fund (s.20AO(4)).

3.3.3 Profits not exempted from profits tax: ss.20AP and 20AQ

Profits derived by a fund or a SPE ('specified body') from the following transactions will not be exempt from tax:

- (a) Transactions in shares, stocks, debentures, loan stocks, funds, bonds or note ('specified securities') of, or issued by, a private company ('relevant company'), where the relevant company directly or indirectly holds immovable property in Hong Kong or shares in another private company that directly or indirectly holds immovable property in Hong Kong, and the aggregate value of the holding in such immovable property and shares exceeds 10% of the value of the relevant company's total assets (s.20AP(1) and (2)(a)).

For this purpose, immovable property does not include infrastructure, which is defined to mean any publicly or privately owned facility providing or distributing services for the benefit of the public, and includes any water, sewage, energy, fuel, transportation or communication facility (s.20AP(4)).

If the aggregate value of the immovable property and shares held by the relevant company does not exceed 10% of the value of the relevant company's total assets, the specified body will not be taxed on its profits from the above transactions provided that the following condition is met in good faith by the specified body (s.20AP(2)(b)):

- (i) **Holding period condition** – the investment in the relevant company has been held by the specified body for at least 2 year, whether or not the specified body has control over the relevant company (s.20AP(3)(a)); or
- (ii) **Short-term asset condition** – if the holding period condition is not met, profits tax exemption will only be provided if (1) the specified body does not have control over the relevant company; or (2) the specified body has control over

the relevant company, but the latter does not directly or indirectly hold short-term assets the aggregate value of which exceeds 50% of the value of the total assets of the relevant company (s.20AP(3)(b)).

For this purpose, a short-term asset means an asset that (1) is of a non-Sch. 16C class; (2) is not immovable property in Hong Kong; and (3) has been held by the relevant company for less than 3 consecutive years before the specified body disposes of the shares of, or debentures issued by, the relevant company (s.20AP(4)).

- (b) Transactions in specified securities of, or issued by, a relevant company, where the relevant company does not directly or indirectly hold immovable property in Hong Kong or shares in another private company that directly or indirectly holds immovable property in Hong Kong (s.20AQ(1)).

However, the specified body will not be taxed on its profits from the above transactions provided that the above holding period condition or the short-term asset condition is met in good faith by the specified body (ss.20AQ(2) and (3)).

3.3.4 Profits not exempted from profits tax: s.20AS

Profits derived by a OFC from transactions in respect of assets of a non-Sch. 16C class held pursuant to a direct trading or direct business undertaking in Hong Kong, or where such assets are utilised to generate income, are not exempt from profits tax (s.20AS).

3.3.5 S.20AP and s.20AQ not applicable to a partner fund: s.20AR

S.20AP and s.20AQ do not apply to a partner fund carrying on a trade, profession or business that involves transactions in shares of an investee company, which means:

- (a) a corporation that has ITVFC and a partner fund as shareholders under the ITVF Scheme; or
- (b) a corporation that
- (i) had, at any time, ITVFC and a partner fund ('Fund A') as shareholders under the ITVF Scheme; and
 - (ii) has, since that time, continued to have a partner fund (whether Fund A or another partner fund) as a shareholder.

3.3.6 Loss sustained by funds, SPEs and OFCs: ss.20AU and 20AV

Losses sustained by a tax-exempt fund, SPE and OFC from a transaction referred to in s.20AN(2)(a) or (b) for a fund; s.20AO(2) for a SPE; and s.20AN(2)(a), (b) or (c) for an OFC in a year of assessment are not available for set off against any of its assessable profits for the year of assessment or any subsequent year of assessment (ss.20AU(2) and (3) and 20AV(2)).

Any loss sustained by an OFC from a transaction, a direct trading, a direct business undertaking or utilisation of assets ('specified activity') which is not exempted under s.20AN or 20AS in a year of assessment is only available for set off against its assessable profits from the specified activity for the year of assessment or any subsequent year of assessment (s.20AV(3)).

3.3.7 Deeming provisions for funds and SPEs held by funds: ss.20AX and 20AY

To prevent resident persons taking advantage of the exemptions by investing through a fund, anti-avoidance provisions are introduced.

Under ss.20AX(1), (2) and (3), a resident person who:

- (a) Alone or jointly with his associates (whether a resident person or not) holds direct and/or indirect beneficial interest of not less than 30% in a tax-exempt fund; or

(b) Holds any percentage in a tax-exempt fund if the fund is his associate;

will be deemed to have derived assessable profits in respect of the profits of the fund exempted under s.20AN, regardless of whether the resident person has received or will receive, directly or indirectly, any profit distribution from the fund (s.20AX(4)).

Under ss.20AY(1) and (2), a resident person who:

(a) alone or jointly with his associates (whether a resident person or not) holds direct and/or indirect beneficial interest of not less than 30% in a tax-exempt fund; or holds any percentage in a tax-exempt fund if the fund is his associate; and

(b) the fund has a direct and/or indirect beneficial interest in a tax exempt SPE,

will be deemed to have derived assessable profits in respect of the profits of the SPE exempted under s.20AO, regardless of whether the resident person has received or will receive, directly or indirectly, any profit distribution from the SPE (s.20AY(3)).

The term 'associate' is widely defined in s.20AN(6).

If the resident person is able (or might reasonably be expected to be able) to control the activities of the trust estate or the application of its corpus or income, the resident person is regarded as being interested in 100% of the value of the trust estate (ss.20AX(5) and 20AY(4)).

The amount of deemed profits is ascertained by reference to the percentage of the resident person's beneficial interest in the fund and the length of ownership within the relevant year of assessment (ss.20AX(6) and (7);20AY(5) and (6)).

However, the deeming provision will not by itself deem the resident person to be carrying on a business in respect of his other activities, will not impose any new tax, and will not be invoked in respect of offshore profits, capital gains nor dividend income.

The deeming provisions will not apply to a resident person if the Commissioner is satisfied that beneficial interests in the fund are bona fide widely held (ss.20AX(8)) and 20AY(7)).

Section 4
Page 431

Under section 4 Avoidance of double taxation, replace the sentence after 'Topic highlights' with:

As of 1 June 2018, Hong Kong has signed 40 comprehensive double taxation agreements and arrangements ('DTAs').

Replace the third paragraph with the following:

The Avoidance of Double Taxation on shipping and air services income is also covered by the comprehensive DTAs signed by the Hong Kong Government. As of 1 June 2019, Hong Kong has concluded comprehensive DTAs with 40 jurisdictions including Austria, Belarus, Belgium, Brunei, Canada, the Czech Republic, Finland, France, Guernsey, Hungary, India, Indonesia, Ireland, Italy, Japan, Jersey, Korea, Kuwait, Latvia, Liechtenstein, Luxembourg, the mainland of China, Malaysia, Malta, Mexico, the Netherlands, New Zealand, Pakistan, Portugal, Qatar, Romania, Russia, Saudi Arabia, South Africa, Spain, Switzerland, Thailand, the United Arab Emirates, the United Kingdom and Vietnam.

Topic recap Page 432	<p>Under the heading 'Some special provisions for non-residents', revise the third column from the left to 'Profits from deemed trading receipts under ss.15(1)(a), (b), (ba) or (bb) (s.21A)'; delete the column 'Business with closely connected residents (s.20)'; and revise the third column from the right to 'Exemption for offshore funds, offshore private equity funds, funds and open-ended fund companies (ss.20AB, AC, ACA, ACB, AD, AE, AF, AM to AY).</p> <p>Under the column 'Double Taxation Agreements (DTAs)', replace '37 comprehensive' with '40 comprehensive'.</p>
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Chapter 5 Hong Kong salaries tax

Topic list Page 441

Add the following sections to the topic list:

5.10 Qualified premium for eligible health insurance products

5.11 Deferred annuity premiums and MPF Voluntary Contributions

Section 1 Page 446

Add the following at the beginning of the paragraph for 8(1A)(c) in the 1st table on page 446:

Subject to s.8(1C) and s.50AA, excludes

Replace the paragraph on s.8(1A)(c) in the middle of Page 446 with the following:

S.8(1A)(c) indicates that subject to s.8(1C) and s.50AA, income arising in or derived from Hong Kong from any employment excludes income derived from services outside Hong Kong, provided that such income was chargeable to overseas tax of similar nature to salaries tax, and that overseas tax was actually paid. Specifically s.8(1C) excludes the applicability of s.8(1A)(c) if the overseas territory has entered into a double tax treaty with Hong Kong, and in this regard the tax payable is to be allowed as tax credit against tax payable in Hong Kong under s.50.

Section 5.7 Page 469

Update the table in section 5.7 Elderly residential care expenses, on page 469 as follows:

Year of assessment	Deduction ceiling for elderly residential care expenses (per qualified parent or grandparent)
Before 2011/12	\$60,000
2011/12	\$72,000
2012/13 and 2013/14	\$76,000
2014/15 and 2015/16	\$80,000
2016/17 and 2017/18	\$92,000
2018/19 & onwards	\$100,000

**New section
5.10
Page 472**

Add a new section 5.10 after section 5.9 on page 472 as follows:

5.10 Qualified premium for eligible health insurance products (s.26K)

2018/19 Budget proposed to introduce a tax deduction of qualified premium for eligible health insurance products under the Voluntary Health Insurance Scheme.

The Inland Revenue (Amendment) (No. 4) Bill 2018 was gazetted and such deduction will become effective from the year of assessment 2019/20.

A tax deduction under salaries tax and personal assessment is available to people who purchase eligible health insurance products for themselves or their specified relatives under the Voluntary Health Insurance Scheme. The deduction is capped at \$8,000 per each insured person by the taxpayer. Specifically, each taxpayer can claim deduction for more than one insured person on the basis that the insured persons are specified relatives. Yet the deduction is again capped at \$8,000 per each insured person.

Specified relatives include the taxpayer's spouse and children, and the taxpayer's or his/her spouse's grandparents, parents and siblings.

**New section
5.11
Page 472**

Add the following new section 5.11 after section 5.9 and new section 5.10 on page 472:

5.11 Deferred annuity premiums and MPF Voluntary Contributions (s.26O and s.26S)

Inland Revenue and MPF Schemes Legislation (Tax Deductions for Annuity Premiums and MPF Voluntary Contributions) (Amendment) Bill 2018 was gazetted on 7 December 2018.

Starting from 1 April 2019, the maximum deduction for deferred annuity premiums and MPF Voluntary Contributions by a taxpayer is \$60,000 per year of assessment. This is the aggregate limit for MPF voluntary contributions and deferred annuity premiums

The taxpayers can claim deductions under salaries tax and personal assessment up to the cap of \$60,000.

A taxpayer can claim tax deductions for deferred annuity premiums covering his or her spouse as joint annuitant; or either the taxpayer or the taxpayer's spouse as a sole annuitant. Yet the deduction claim in this circumstance is still \$60,000 for each taxpayer.

A married couple, who both have taxable income, can also allocate tax deductions for deferred annuity premiums amongst themselves in order to claim the total deduction of \$120,000, provided that the deductions claimed by each taxpayer do not exceed the individual limit of \$60,000.

Tax deductible MPF voluntary contributions are subject to 'preservation requirements'. The accrued benefits can be withdrawn only upon reaching the age of 65 or based on statutory grounds.

**Section 6
Table
Page 474**

Add the following two new columns in the table of personal allowances for 2018/19 and 2019/20 in section 6:

Allowances	2018/19 onwards
	HK\$
Basic allowance	132,000
Married person's allowance	264,000
Child allowance – 1st to 9th (each)	120,000
Newborn child (each)	120,000
Dependent parent/grandparent allowance - for parent aged 60 or more* (each)	50,000
Dependent parent/grandparent allowance - for parent aged between 55 and 59 (each)	25,000
Additional dependent parent/grandparent allowance – for parent aged 60 or more* (each)	50,000
Additional dependent parent/grandparent allowance – for parent aged between 55 and 59 (each)	25,000
Dependent brother/sister allowance (each)	37,500
Disabled dependant allowance (each)	75,000
Single parent allowance (irrespective of the numbers of children being maintained)	132,000
Personal disability allowance	75,000

(*) Also if the dependent parent/grandparent is eligible to claim an allowance under the Government's Disability Scheme.

**Table in
Section 6
Page 477**

Modify the 'Scope' column for claiming 'dependent brother/sister allowance' in the Table of Personal allowance in section 6 on page 477:

Natural/adopted/step-brother or -sister of the taxpayer or his/her spouse or any deceased spouse(s) of the taxpayer.

If the person or the spouse is adopted, a natural child of an adoptive parent of the person or the spouse.

Section 6
Page 478

Add the following for the newly introduced personal disability allowance at the end of the table in section 6 on page 478:

Allowance	Scope	Conditions
Personal disability allowance	Taxpayer himself/herself	If a taxpayer is eligible to claim an allowance under the Government's Disability Allowance Scheme, he/she can claim this newly introduced personal disability allowance.

Section 7.3
Page 479

Modify the progressive tax rate table in section 7.3 on page 479 for 2017/18 and add a new tax rate table for 2018/19 & onwards:

2017/18	
First \$45,000	2.0%
Next \$45,000	7.0%
Next \$45,000	12.0%
Balance	17.0%

2018/19 and onwards	
First \$50,000	2.0%
Next \$50,000	6.0%
Next \$50,000	10.0%
Next \$50,000	14.0%
Balance	17.0%

Section 7.3
Page 479

Add the following two additional concessionary deductions in the sample salaries tax computation in section 7.3 on page 479:

Qualified premium for eligible health insurance products (S.26K)

Qualified deductions for deferred annuity premiums and MPF Voluntary Contributions (S.26O and s.26S)

Section 7.3
Page 480

Modify the following in the partial tax relief table for salaries tax and personal assessment under section 7.3 on page 480:

	2016/17	2017/18	2018/19
% of final tax reduction	75%	75%	75%
Maximum limit	20,000	30,000	20,000

Chapter 7 Personal assessment
Section 2.2 **Add the following at the end of section 2.2 on page 549:**
Page 549

The 2018/19 Budget proposed to relax the requirement for the election of personal assessment by allowing married persons the option to elect personal assessment separately starting from the year of assessment 2018/19.

The Inland Revenue (Amendment) (No. 5) Bill 2018 was passed by the Legislative Council on 14 November 2018.

Starting from the year of assessment 2018/19, husband and wife have the option to elect personal assessment separately. Specifically, election for personal assessment jointly by spouse is applicable only when both of them have income assessable to tax. In addition, the election of personal assessment jointly by spouse is mandatory if both of them are jointly assessed under salaries tax.

Chapter 8 Hong Kong stamp duty
Section 1 **Replace the second sentence under Topic highlights with the following:**
Page 571

The SDO is made up of Parts 1 – 7 with ss.1 to 73 and 10 schedules.

Section 2.1 **Under section 2.1 Chargeable instruments, replace the stamp duty payable**
Pages 572 **under Head 1(1) and Head 1(1A) with the following:**
and 573

Head	Stamp duty
1(1)	1.5% – 15% (Part 1 and Part 2 of Scale 1 rates); or \$100 or 1.5% – 4.25% (Scale 2 rates); on the higher of the consideration and market value
1(1A)	1.5% – 15% (Part 1 and Part 2 of Scale 1 rates); or \$100 or 1.5% – 4.25% (Scale 2 rates); on the higher of the consideration and market value

Section 3.1.1 **Add 'Part 1 or Part 2 of' before 'Scale 1 rates will not be applicable under**
Pages 579 **the following circumstances:'**

Under (A) When Scale 2 rates are applicable to:

Add 'However, if the instrument is executed on or after 12 April 2017 for acquisition of more than one RPPT, it will be subject to AVD at Part 1 of Scale 1.' to the end of (a).

Add 'However, if the instrument is executed on or after 12 April 2017 for acquisition of more than one RPPT, it will be subject to AVD at Part 1 of Scale 1.' to the end of (b).

Section 3.1.1 **Replace the sentence under (C) When entitled to a partial refund of AVD for**
Pages 580 **with the following:**

- (a) Acquisition of a RPPT or non-RPPT (including bare sites) for the purpose of redevelopment.
 - (b) HKPR who changes his/her only RPPT.
-

Example 4
Page 580**Replace the last paragraph with the following:**

The deed of gift is the chargeable instrument. As the property is a non-RPPT, AVD at Part 2 of Scale 1 rates will be payable based on the market value on the date of transfer, \$5.3 million at 6%, i.e. \$318,000.

Section 3.1.1
Page 580**Delete the last paragraph and add the following paragraphs:**

The Stamp Duty (Amendment) Ordinance 2018 was gazetted on 19 January 2018. With effect from 5 November 2016, Scale 1 AVD rates are divided into Part 1 and Part 2. The rates at Scale 1 are as follows:

Part 1 of Scale 1: a flat rate of 15% of the consideration or value of the property, whichever is the higher.

Part 2 of Scale 1 (original Scale 1 rates of 1.5% – 8.5%):

Consideration/market value	Rates at Scale 1 (Part 2)
Up to \$2,000,000	1.5%
\$2,000,001 – \$2,176,470	\$30,000 plus 20% of the excess over \$2,000,000
\$2,176,471 – \$3,000,000	3%
\$3,000,001 – \$3,290,330	\$90,000 plus 20% of the excess over \$3,000,000
\$3,290,331 – \$4,000,000	4.5%
\$4,000,001 – \$4,428,580	\$180,000 plus 20% of the excess over \$4,000,000
\$4,428,581 – \$6,000,000	6%
\$6,000,001 – \$6,720,000	\$360,000 plus 20% of the excess over \$6,000,000
\$6,720,001 – \$20,000,000	7.5%
\$20,000,001 – \$21,739,130	\$1,500,000 plus 20% of the excess over \$20,000,000
Over \$21,739,130	8.5%

Application of Part 1 of Scale 1

Unless specifically exempted or otherwise provided, Part 1 of Scale 1 applies to an AFS for the acquisition of any RPPT executed on or after 5 November 2016, and to the COS of such a property executed on or after that date (unless the related AFS was executed before 5 November 2016). However, Part 1 of Scale 1 does not apply to an AFS/COS for a RPPT where the purchaser/transferee is a HKPR (or he is a tenant or an authorized occupant of the Housing Authority who acquires the RPPT under the Tenants Purchase Scheme) acting on his own behalf and does not own any other RPPT in Hong Kong at the time of acquisition of the subject property, irrespective of whether the purchaser/transferee is acquiring a RPPT for the first time. Only the lower rates (Scale 2) will apply to such AFS/COS.

However, instruments executed on or after 12 April 2017 for the sale and purchase or transfer of more than a single RPPT, unless specifically exempted or otherwise provided in the law, will be subject to AVD at the flat rate of 15%.

Thus, a HKPR who acquires more than a single RPPT under an instrument will be liable to pay AVD at a flat rate of 15%, irrespective of whether or not he/she is a beneficial owner of any other RPPT in Hong Kong on the date of acquisition of the subject properties.

The SDO has not exhaustively defined the term 'single RPPT'. However, it provides that a 'single RPPT' includes:

- (a) A unit and a roof situated in the same building;
- (b) A unit and an adjacent flat roof situated in the same building;
- (c) A unit and an adjacent garden;
- (d) Two residential units that became a single unit as shown by the following documents that the walls or the floor, or any part of the walls or the floor separating the two units has been demolished and the two units have become one single residential unit:
 - (i) A building plan and a letter issued by the Building Authority acknowledging receipt of a certificate of completion of the building works relating to the demolition as required under the Building (Administration) Regulations; or
 - (ii) A plan signed by an authorised person after the completion of the building works relating to the demolition.

The Stamp Office will refer to the building plans approved by the Building Authority, the deed of mutual covenant, the occupation permit and other documents, such as the developer's sale brochures, to determine whether the subject property under an instrument is a single RPPT.

An AFS/COS by which a HKPR acquires a RPPT together with a car parking space is chargeable with to AVD at Scale 2 rates under s.29AK if:

- (a) The HKPR is acting on his/her own behalf; and
- (b) The HKPR is neither a beneficial owner of any other RPPT nor a beneficial owner of any other car parking space in HK

Application of Part 2 of Scale 1

Unless specifically exempted or otherwise provided, Part 2 of Scale 1 applies to an AFS for the acquisition of any RPPT executed on or after 23 February 2013 but before 5 November 2016; and to an AFS for the acquisition of any non-RPPT executed on or after 23 February 2013.

Section 3.1.2 **Under section 3.1.2 Partial refund of AVD, add the following paragraph after**
Page 581 **the last paragraph:**

For HKPRs who change their RPPT and wish to claim partial refund of the AVD paid on acquisition of the new RPPT, the Stamp Duty (Amendment) Ordinance 2018 also extends the time limit for the disposal of the original RPPT from within 6 months to within 12 months after the date of conveyance of the new RPPT if the new RPPT is acquired on or after 5 November 2016.

New section **Add a new section 3.1.3 after section 3.1.2 on page 581:**
3.1.3
Page 581 **3.1.3 Acquisition of more than one residential property under**
 one single instrument

To tighten up the exemption arrangement for HKPR, the Stamp Duty (Amendment) (No. 2) Ordinance 2018 was gazetted on 20 April 2018. Unless specifically exempted or otherwise provided, instruments executed on or after 12 April 2017 for the sale and purchase or transfer of more than a single RPPT will be subject to AVD at the flat rate of 15%, even if the purchaser/transferee is a HKPR who is acting on his/her own behalf and is not a beneficial owner of any other RPPT in Hong Kong at the time of acquisition of the subject properties.

Example 8
Page 584

Replace the second last sentence in the last paragraph with the following:
AVD at Part 2 of Scale 1 rates is payable on \$9 million at 7.5%, i.e. \$675,000.

Example 9
Page 584

Add the following paragraph after the last paragraph:
If the RPPT was purchased on 1 March 2018, the flat rate of 15% under Part 1 of Scale 1 will apply. The AVD payable will then be \$1,500,000 (\$10 million × 15%).

New Example
9a
Page 584

Add the following example after Example 9:



Example 9a

On 1 March 2019, a HKPR entered into an AFS to purchase a RPPT for \$21 million. At the time of acquisition, the HKPR did not own any other RPPT in Hong Kong. On 1 April 2019, his spouse, who already owned an RPPT in Hong Kong, was added in the assignment as one of the joint owners of the property.

As the HKPR does not own any other RPPT in Hong Kong, AVD at Scale 2 rates is payable on the AFS under Head 1(1A) on \$22 million at 4.25%, i.e. \$935,000.

Notwithstanding that the spouse already owned an RPPT in Hong Kong, AVD at Scale 2 rates is payable on the assignment, which is computed by reference to the stated consideration or the value of the property, whichever is the higher, less part of the SD representing the share of the interest of the HKPR in the property. Therefore, AVD payable is \$467,500 (\$22 million × 4.25% × 50%).

If the spouse does not own any other RPPT in Hong Kong, nomination of a close relative who does not own any other RPPT in Hong Kong will not attract any AVD. The assignment will be charged with a fixed duty of \$100 only under Head 1(1).

Example 10
Page 585

Replace the last sentence in the first paragraph with the following:

AVD at Part 2 of Scale 1 rates will be imposed on:

Example 11
Page 585

Replace the first sentence in the first paragraph with the following:

In 2017, A signed an AFS to purchase a non-RPPT from B at \$5 million, and AVD at Part 2 of Scale 1 rates on the AFS was charged at 6% on \$5 million.

Replace the last paragraph with the following:

If, instead of admitting his parent, spouse and child, A admitted his brother and sister as joint owners, further AVD at Part 2 of Scale 1 rates will be payable on the COS in the amount of \$200,000 (\$5 million × 6% × 2/3); and SSD will also be payable (see the discussion in **section 3.3** on 'Special stamp duty' below).

New Example 16a
Page 591



Example 16a

Same as Example 16, except that the RPPT transactions all took place in 2019.

Solution

As Mr. L and Mr. M are HKPRs and do not own any other RPPT in Hong Kong, AVD at Scale 2 rates is payable on the PAFS under Head 1(1A) on \$6 million at 3%, i.e. \$180,000.

As Mr. N is a non-HKPR and is not a close relative of Mr. L nor Mr. M, AVD at Part 1 of Scale 1 rate of 15% is payable on the AFS under Head 1(1A) on Mr. N's share of interest (\$6 million \times 1/3), i.e. \$300,000.

The amount of SSD and BSD payable, and stamp duty on the deed of assignment remain the same, i.e. \$400,000, \$900,000 and \$100 respectively.

Example 22
Page 596

Replace the first sentence in the first paragraph with the following:

On 1 April 2018, X signed an AFS to sell an office to Y.

Replace the second last sentence in the last paragraph with the following:

The AFS is dutiable under Head 1(1A), and the AVD at Part 2 of Scale 1 rates is \$562,500 (\$7.5 million \times 7.5%).

New Example 24a
Page 601

Add the following example after Example 24:



Example 24a

Same as Example 24, except that the RPPT was purchased on 1 February 2017 and Connie assigned her one-third share in the property on 1 July 2018.

Solution

Since the assignment of Connie's share in the property is executed after 5 November 2016, AVD at Part 1 of Scale 1 rate of 15% is payable, i.e. \$240,000 (\$1,600,000 \times 15%).

The amount of SSD and BSD payable remains the same, i.e. \$160,000 and \$240,000 respectively.

Answer 5
Page 631

Replace the second sentence in the first paragraph under part (c) with the following:

The AFS is chargeable with AVD at Part 1 of Scale 1 rate of 15% (for RPPT) or Part 2 of Scale 1 rates (for non-RPPT) under Head 1(1A) on the higher of the consideration and market value of the property.

Further reading Page 640	Under Primary References, change SOIPN 8 to SOIPN 8 (Revised)
Answers to exam practice questions Page 961	<p>Mr. Pang – under part (a), replace the second sentence of the first paragraph with the following:</p> <p>The conveyance will be chargeable to AVD at Part 2 of Scale 1 rates under Head 1(1) on the market value of Property A.</p>
Answers to exam practice questions Pages 967 and 968	<p>E Ltd – under part (a), replace the first paragraph and the first sentence of the second paragraph with the following:</p> <p>The agreement for sale ('AFS') executed between E Ltd and F Ltd on 1 February 2017 is chargeable with ad valorem duty ('AVD') at Part 2 of Scale 1 rates under Head 1(1A) in the First Schedule.</p> <p>The AFS executed between E Ltd and G Ltd on 15 July 2017 is again chargeable with AVD at Part 2 of Scale 1 rates under Head 1(1A).</p> <p>E Ltd – under part (c), replace the first sentence of the second paragraph with the following:</p> <p>Provided that the AFS is duly stamped, the assignment executed on 1 April 2017 will be chargeable with AVD at Scale 2 rates under Head 1(1) by reference to the consideration less a fraction of the AVD representing the proportion of the flat that is vested in Mr. K (i.e. 1/2) (s.29D(4)).</p>
Answers to exam practice questions Page 969	<p>Anomalistic Ltd – under part (a), replace the first sentence of the second paragraph with the following:</p> <p>As Property X is a commercial property, the transfer is subject to Part 2 of Scale 1 rates under Head 1(1) or Head 1(1A).</p> <p>Anomalistic Ltd – under part (c), replace the last sentence of the second paragraph with the following:</p> <p>The AVD is therefore \$2,400,000 (\$16,000,000 × 15%) in accordance with Part 1 of Scale 1 rates under Head 1(1) (para. 39, SOIPN No. 8).</p>
Chapter 9 Introduction to tax planning	
Topic list Page 643	<p>Delete 4.16 section 20 and add the following sections to the topic list:</p> <p>4.6A Section 14M – Aircraft leasing tax concessions: anti-avoidance provisions</p> <p>4.17A Section 20AX and 20AY – Assessable profits of funds and special purpose entities held by funds regarded as assessable profits of resident person</p>
Section 3 Page 649	<p>Replace the second paragraph from the top to the first paragraph under 'Fundamental Principles' by the following paragraphs:</p> <p>A professional accountant is required to comply with the following Fundamental Principles as outlined in the Institute's 'Code of Ethics for Professional Accountants' (section 110) (Revised November 2018):</p> <p>(a) <i>Integrity</i> – to be straightforward and honest in all professional and business relationships.</p> <p>(b) <i>Objectivity</i> – not to compromise professional or business judgments because of bias, conflict of interest or undue influence of others.</p>

- (c) *Professional competence and due care* – to:
- (i) Attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organisation receives competent professional service, based on current technical and professional standards and relevant legislation; and
 - (ii) Act diligently and in accordance with applicable technical and professional standards.
- (d) Confidentiality – to respect the confidentiality of information acquired as a result of professional and business relationships.
- (e) Professional behaviour – to comply with relevant laws and regulations and avoid any conduct that the professional accountant knows or should know might discredit the profession.

The Institute has also specified Ethics in Tax Practice in the 'Code of Ethics for Professional Accountants' (Section 600) as follows:

Fundamental Principles

The fundamental principles to be observed when developing ethical requirements relating to tax practice include all five Fundamental Principles by which a member is governed in the conduct of his professional relations with others. These principles are enumerated in Section 110 'The Fundamental Principles' under Chapter A and expanded upon in the rest of the Code.

**Section 3
Page 650**

Replace the second paragraph (b) in point (5) by the following paragraph:

- (b) Act according to paragraphs R360.38 – 360.40 A1 under Chapter A of the Code, including consider whether disclosing the matter to the external auditor and/or the IRD.

Replace paragraph (a) in point (8) by the following paragraph:

- (a) He should promptly advise his client of the error or omission and recommend that the client make disclosure to the IRD.

Add a new paragraph (d) to point (8):

- (d) He should consider, as set out in paragraphs R360.38 – 360.40 A1 under Chapter A of the Code, whether disclosing the matter to the external auditor and/or the IRD is appropriate.

**Section 4
Page 651**

Under section 4 Anti-avoidance provisions under the IRO, delete s.20 and add the following sections after s.9A and 20AF in the table:

Section	Scope	Enforced by
14M	Aircraft leasing tax concessions: anti-avoidance provisions	Not specified
20AX and 20AY	Assessable profits of funds and special purpose entities held by funds regarded as assessable profits of resident person	Not specified

New section **Add a new section 4.6A after section 4.6:**

4.6A

Page 664

4.6A Section 14M – Aircraft leasing tax concessions: anti-avoidance provisions

S.14M was enacted on 7 July 2017 to ensure that the chargeable profits from a transaction between a qualifying aircraft lessor ('QAL') and its associate in connection with a qualifying aircraft leasing activity should be determined by reference to the amount of profits that would have accrued had the same transaction been carried out at arm's length terms between parties who are not associates (ss.14M(1) and (2)). This arm's length principle also applies to a qualifying aircraft leasing management activity between a qualifying aircraft leasing manager ('QALM') and its associate (ss.14M(3) and (4)).

Ss.14M(1) to (4) sets out the conditions where the profits in respect of transactions in connection with a qualifying aircraft leasing activity or a qualifying aircraft leasing management activity between a qualifying entity and its associates may be subjected to adjustment.

Where a QAL defeases an aircraft owned via a funding lease, a hire-purchase agreement or a conditional sale agreement to a third party, the QAL is no longer obliged to make payments under such ownership arrangement, and the QAL would be treated as if it had ceased to own the aircraft. Hence, no profits tax concessions will be granted to the QAL in respect of the leasing transaction with the aircraft operator as it is no longer a qualifying aircraft leasing activity as defined in s.14G(6) (s.14M(5)).

Application of this provision is also discussed in Chapter 3, section 5.9.5 on 'Anti-avoidance provisions in s.14M'.

Section 4.16

Page 668 to

669

Delete the entire Section 20 – Liability of certain non-resident persons.**New section**

4.17A

Page 669

Add a new section 4.17A after section 4.17:**4.17A Sections 20AX and 20AY – Assessable profits of funds and special purpose entities held by funds regarded as assessable profits of resident person**

Ss.20AX and 20AY prevent resident persons taking advantage of the exemption for funds by investing through funds.

Under s.20AX (1), (2) and (3), a resident person who:

- (a) Alone or jointly with his associates (whether a resident person or not) holds direct and/or in direct beneficial interest of not less than 30% in a tax-exempt fund; or
 - (b) Holds any percentage in a tax-exempt fund if the fund is his associate;
- will be deemed to have derived assessable profits in respect of the profits of the fund exempted under s.20AN, regardless of whether the resident person has received or will receive, directly or indirectly, any profit distribution from the fund (s.20AX(4)).

Under ss.20AY(1) and (2), a resident person who:

- (a) alone or jointly with his associates (whether a resident person or not) holds direct and/or indirect beneficial interest of not less than 30% in a tax-exempt fund; or holds any percentage in a tax-exempt fund if the fund is his associate; and
- (b) the fund has a direct and/or indirect beneficial interest in a tax exempt SPE,

will be deemed to have derived assessable profits in respect of the profits of the SPE exempted under s.20AO, regardless of whether the resident person has received or will receive, directly or indirectly, any profit distribution from the SPE (s.20AY(3)).

For details, refer to the discussions in **Chapter 4, section 3.3.5** on 'Deeming provisions for open-ended fund companies'.

Example 26
Page 701

Under Stamp duty implications, replace the first sentence in the first paragraph with the following:

As the residential property (RPPT) is located in Hong Kong, the agreement for sale and purchase (AFS) of the RPPT will be liable to AVD at Part 1 of Scale 1 rates under Head 1(1A) of the SDO at the rate of 15% on the higher of the consideration or the unencumbered value of the RPPT. The formal assignment executed in conformity with the stamped AFS will only be liable to affixed duty of \$100.

Topic recap
Page 722

Under the column 'Specific provision', add s.14M, s.20AX and s.20AY and delete s.20.

Chapter 12

Double taxation arrangements and agreements

Topic list
Page 817

Add the following section to the topic list:

4.6 Transfer pricing documentation and Country-by-Country Reporting

Learning focus
Page 817

Replace the first sentence of the Learning focus on page 817 with the following:

As of 1 June 2019, Hong Kong has signed 40 comprehensive double taxation arrangements and agreements.

Section 1.1
Page 820

Replace the last paragraph in section 1.1 on page 820 with the following:

As of 1 June 2019, Hong Kong has signed 40 comprehensive DTAs, including Belgium, Thailand, the mainland of China, Luxembourg, Vietnam, Brunei, the Netherlands, Indonesia, Hungary, Kuwait, Austria, the United Kingdom, Ireland, Liechtenstein, France, Japan, New Zealand, Switzerland, Portugal, Spain, the Czech Republic, Malta, Jersey, Malaysia, Mexico, Canada, Italy, Guernsey, Qatar, Korea, South Africa, United Arab Emirates ('UAE'), Romania, Russia, Latvia, Belarus, Pakistan, Saudi Arabia, India and Finland.

New section
3.1.15
Page 830

Add a new section 3.1.15 after section 3.1.14 on page 830 and renumber the original section 3.1.15 on page 830 as section 3.1.16:

3.1.15 Visiting teachers and researchers

The Inland Revenue (Amendment) (No. 7) Bill 2018 was passed by the Legislative Council on 20 February 2019.

The Hong Kong Government has agreed with the PRC Government for the introduction of a teachers and researchers Article in the China-HK DTA so as to relieve the tax burden for Hong Kong teachers and researchers working in the PRC.

The amendment also helps to avoid double non-taxation of income of visiting teachers and researchers.

Section 4.3.3 **Replace the second last paragraph in section 4.3.3 on page 841 with the following:**
Page 841

As of 1 June 2019, Hong Kong signed CAAs with 15 jurisdictions including Belgium, Canada, Guernsey, Indonesia, Ireland, Italy, Japan, Korea, Mexico, the Netherlands, New Zealand, Portugal, South Africa, Switzerland and the United Kingdom.

Section 4.3.3 **Add the following after the last paragraph in section 4.3.3 on page 841:**
Page 841

Inland Revenue (Amendment) (No. 2) Ordinance 2017

The Inland Revenue (Amendment) (No. 2) Ordinance 2017 was gazetted on 16 June 2017 and came into effect from 1 July 2017.

From 1 July 2017, the list of 'reportable jurisdictions' under the Inland Revenue Ordinance has been expanded to cover 75 jurisdictions, comprising those confirmed AEOI partners and prospective AEOI partners. The prospective AEOI partners include the following three categories:

- (a) Jurisdictions which have expressed an interest in conducting AEOI with Hong Kong or jurisdictions suggested by the OECD;
- (b) Hong Kong's tax treaty partners which have committed to AEOI; and
- (c) All member states of the EU.

With effect from 3 July 2017, AEOI Portal has been launched for financial institutions to furnish notifications and file returns in relation to the reporting of financial account information for AEOI purposes.

Financial Institutions have to register under the AEOI Portal in order to use the online services. Financial institutions maintaining reportable accounts on or before 3 July 2017 are required to register under the AEOI Portal and submit a notification of commencement of maintaining reportable accounts no later than 3 October 2017. Financial institutions who commence to maintain any reportable accounts after 3 July 2017 should submit the required notifications through the AEOI Portal within three months from the commencement of maintaining such accounts.

Inland Revenue (Amendment) (No. 5) Bill 2017

The Inland Revenue (Amendment) (No. 5) Bill 2017 was gazetted on 6 October 2017. This Amendment Bill seeks to pave the way for Hong Kong's participation in the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, and to align the IRO with the CRS promulgated by the OECD.

The Multilateral Convention is an important platform for Hong Kong to implement AEOI and combat base erosion and profit shifting.

Currently, the IRO does not give effect to multilateral tax agreements or arrangements for international tax co-operation other than providing relief from double taxation and exchange of information. This Amendment Bill aims to remove the limitation so as to facilitate Hong Kong's participation in multilateral tax agreements and new areas of international tax co-operation.

Furthermore, this Amendment Bill makes necessary legislative amendments to align the IRO with the CRS by removing inconsistencies identified.

Inland Revenue (Amendment) Ordinance 2018

The Inland Revenue (Amendment) Ordinance 2018 was gazetted on 2 February 2018. The technical amendments on AEOI (i.e. clauses 5 to 11) under the (Amendment) Ordinance 2018 came into operation on 1 January 2019 while other provisions took effect on 2 February 2018.

The (Amendment) Ordinance 2018 provides the legal framework for Hong Kong to implement multilateral tax arrangements and thereby allows more effective implementation of the arrangements relating to AEOI as well as automatic exchange of country-by-country reports and spontaneous exchange of information on tax rulings under the BEPS package.

The (Amendment) Ordinance makes technical amendments to certain provisions (i.e. clauses 5 to 11) on AEOI so as to align them with the CRS promulgated by the OECD.

These amendments do not make substantial changes to the due diligence requirements for reporting FIs. However, considering that reporting FIs will take time to fine-tune their systems and mode of operation in order to implement the refinements, such provisions will only become effective on 1 January 2019. In other words, the existing AEOI provisions will continue to apply to FIs' reports for 2018 which will be due for submission in mid-2019. The refined provisions under the (Amendment) Ordinance will apply to FIs' reports for 2019 which will be due for submission in mid-2020 and thereafter.

The scope of information to be exchanged, either conducted on a bilateral basis or under the Multilateral Convention, would generally be the same. The (Amendment) Ordinance does not alter the high level of privacy and confidentiality safeguards currently applicable to the handling of tax information under the IRO.

The (Amendment) Ordinance allows Hong Kong to implement the new initiatives on international tax co-operation more effectively and reduces the risk of Hong Kong being identified as a 'non-cooperative tax jurisdiction'.

The Inland Revenue (Convention on Mutual Administrative Assistance in Tax Matters) Order

The Inland Revenue (Convention on Mutual Administrative Assistance in Tax Matters) Order (the Order) was gazetted on 13 July 2018.

The Convention on Mutual Administrative Assistance in Tax Matters became effective in Hong Kong on 1 September 2018.

The Convention provides a multi-party platform for participating jurisdictions to mutually agree with each other on various forms of administrative co-operation in the assessment and collection of taxes, including exchange of information. This allows Hong Kong to effectively implement the AEOI and BEPS action plans promulgated by the OECD.

The number of reportable jurisdictions under the IRO increases from 75 to 126.

Going forwards, Hong Kong will adopt the Convention to implement the automatic exchange of country-by-country reports and spontaneous exchange of information on tax rulings under BEPS.

Arrangement on AEOI between Hong Kong and the PRC

An arrangement between Hong Kong and the PRC for conducting AEOI came into effect on 6 September 2018.

Hong Kong would conduct AEOI with the PRC for the first time along with that for 49 jurisdictions. Hong Kong will continue to deliver its obligations to implement AEOI in accordance with the Common Reporting Standard promulgated by the OECD.

Prior to this arrangement with the PRC, Hong Kong has already activated exchange relationships under AEOI with 49 other jurisdictions on the basis of similar bilateral competent authority agreements or a multilateral competent authority agreement under the Convention on Mutual Administrative Assistance in Tax Matters.

The IRD will exchange the relevant information with their counterparts in the reportable jurisdictions concerned on an annual basis.

The Inland Revenue (Amendment) (No. 7) Bill 2018

The Inland Revenue (Amendment) (No. 7) Bill 2018 was passed by the Legislative Council on 20 February 2019.

The amendment includes refinements to the current AEOI regime to clarify the meanings of certain concepts while removing five categories of institutions from the list of non-reporting financial institutions.

The Inland Revenue (Amendment) (No. 2) Ordinance 2019

The Inland Revenue (Amendment) (No. 2) Ordinance 2019 was gazetted on 1 March 2019.

Salient points are as follows:

- Increase the number of reportable jurisdictions under the IRO from the current 75 to 126;
- Remove Mandatory Provident Fund Schemes, Occupational Retirement Schemes, pooling agreements, approved pooled investment funds and credit unions from the list of non-reporting financial institutions;
- Incorporate the residency rules in relation to financial institutions (other than trusts) that do not have a residence for tax purposes;
- Clarify that the concept of 'controlling person' in relation to a trust, covers trustees and beneficiaries;
- Provide that the Commissioner may publish non-statutory guidelines on the interpretation of AEOI related provisions;

If members of the institutions concerned are tax residents of the reportable jurisdictions, such institutions are required to report to the IRD in Year 2021 for the first time the financial account information of the relevant members in connection with Year 2020. The financial account information will then be transmitted to the relevant tax authorities.

The legislative framework of AEOI will be refined with effect from 1 January 2020 for better aligning the relevant provisions with the requirements promulgated by the OECD.

This Amendment Ordinance also introduced technical refinements to certain AEOI-related provisions of the IRO.

Section 4.5
Page 843

Add the following after the last paragraph of section 4.5 on page 843:

The Inland Revenue (Amendment) (No. 6) Bill 2017 was gazetted on 29 December 2017. The main objectives are to codify the transfer pricing principles into the IRO and implement the minimum standards of the BEPS Action Plans promulgated by the OECD.

The Bill proposes a statutory dispute resolution regime for effective and efficient resolution of disputes through Mutual Agreement Procedures and/or arbitration. This fulfills the requirements of BEPS Action 14 which calls for improving the cross-border dispute resolution mechanism.

The Bill also clarifies the double taxation reliefs available in the presence or in the absence of a tax treaty and proposes to extend the time limit for making fresh foreign tax credit claim from two years to six years after the end of the relevant year of assessment.

Implementing the BEPS Action Plans will demonstrate Hong Kong's commitment to combating cross-border tax evasion. This is vital for Hong Kong to preserve its competitiveness and reputation as an international financial and business centre.

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

The Inland Revenue (Amendment) (No. 6) Ordinance 2018 was gazetted on 13 July 2018.

The Amendment Ordinance implements the minimum standards of BEPS promulgated by the OECD and codifies the transfer pricing principles into the IRO.

The Amendment Ordinance aligns the IRO with the latest guidance promulgated by the OECD.

The codification of the transfer pricing rules provides greater clarity and certainty for taxpayers.

Section 4.6
Page 843

Add a new section 4.6 after section 4.5 on page 843:

4.6 Transfer pricing documentation and Country-by-Country Reporting

The revised OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations recommends jurisdictions to adopt a three-tiered approach for transfer pricing documentation.

The three-tiered approach includes:

- A **Master File** with global information about a multinational group, including specific information on intangibles and financial activities. This would be made available to all relevant country tax administrations;
 - A **Local File** with detailed information on all relevant material inter-company transactions of the particular group entity in each jurisdiction; and
 - A **Country-by-Country (CbC) Report** of income, earnings, taxes paid and certain measures of economic activities.
-

The Inland Revenue (Amendment) (No. 6) Bill 2017 was gazetted on 29 December 2017 to implement key actions arising from BEPS project including transfer pricing documentation.

Salient points are as follows:

Master File and Local File

Mandatory contemporaneous transfer pricing documentation requirements are introduced by the Inland Revenue (Amendment) (No. 6) Bill 2017.

Preparation of Master File and Local File starting from the accounting period on or after 1 April 2018 for Hong Kong entities is required unless any one of the two exemptions are met.

The two exemptions are based on the size of the Hong Kong entity and the volume of related party transactions.

A Hong Kong entity which can satisfy any two of the following three conditions is exempted from the preparation of Master File and Local File:

- Total annual revenue of not more than \$200 million;
- Total assets of not more than \$200 million; and
- Average number of employees of no more than 100.

Furthermore, if the total amount of the following related party transaction does not exceed the respective threshold, Local Files are not required:

- Transfer of properties (other than financial assets and intangibles) – \$220 million;
- Financial asset transactions – \$110 million;
- Transfer of intangible assets – \$110 million; or
- Any other transactions – \$44 million.

If no Local File is required, the Hong Kong entity is not required to prepare the Master File.

The Master File and Local File are required to be prepared within six months after the end of each accounting year.

Country-by-Country (CbC) Report

CbC Report is a minimum standard formulated by the OECD under Action 13 of the BEPS Package.

The CbC Report requires aggregate tax jurisdiction-wide information relating to the global allocation of the income, the taxes paid, and certain indicators of the location of economic activity among tax jurisdictions in which a multinational enterprise group operates. The Report also requires a listing of all the constituent entities for which financial information is reported, including the jurisdiction of incorporation of each of the constituent entities (if different from the tax jurisdiction of residence) and the main business activities carried out by that entity.

CbC Reports are to be exchanged automatically between tax authorities under relevant exchange arrangements.

According to the Inland Revenue (Amendment) (No. 6) Bill 2017, a multinational enterprise group whose annual consolidated group revenue reaches HK\$6.8 billion is required to file a CbC Return, which includes a CbC Report.

If the ultimate parent entity is a resident in Hong Kong, it has the primary obligation to file a CbC Return for each accounting period beginning on or after 1 January 2018. The ultimate parent entity resident in Hong Kong may also voluntarily file a CbC Return for an accounting period beginning between 1 January 2016 and 31 December 2017.

If the ultimate parent entity is not a resident in Hong Kong, it is subject to a secondary obligation to file a CbC Return if any of the following conditions is met:

- The ultimate parent entity is not required to file a CbC Report in its jurisdiction of tax residence;
- The jurisdiction has a current international agreement with Hong Kong providing for automatic exchange of tax information. However, by the deadline for filing the CbC Return, there is no exchange arrangement in place between the jurisdiction and Hong Kong for CbC Reports;
- There has been a systemic failure to exchange CbC Reports by the jurisdiction, which has been notified to the group constituent entities resident in Hong Kong by the Commissioner.

The deadline for filing a CbC Return is 12 months after the end of the relevant accounting period or the date specified in the assessor's notice, whichever is the earlier.

Penalties would be imposed for non-compliance including failing to file CbC Returns and providing misleading, false or inaccurate information in CbC Returns.

At present, the Multilateral Convention is not applicable in Hong Kong. Hence, bilateral arrangements for the exchange of CbC Reports need to be made with jurisdictions having DTAs with Hong Kong. So far, Hong Kong has made such bilateral arrangements with the following jurisdictions:

Jurisdiction	Year for the first exchange of CbC Reports
France	2016
Ireland	2016
South Africa	2016
United Kingdom	2016

The Hong Kong Government will continue negotiation with other existing treaty partners and seeking to conclude as many bilateral arrangements as practicable.

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

The Inland Revenue (Amendment) (No. 6) Ordinance 2018 was gazetted on 13 July 2018.

Salient points are as follows:

The ultimate parent entity of a multinational enterprise (MNE) group which is a Hong Kong tax resident is required to file CbC reports to the IRD for exchange

with other relevant jurisdictions if the annual consolidated group revenue is not less than HK\$6.8 billion.

Taxpayers are required to prepare master files and local files as part of the transfer pricing documentation, subject to certain exemptions.

The Amendment Ordinance gives a statutory basis to the cross-border dispute resolution mechanism (i.e. mutual agreement procedure and arbitration) and advance pricing arrangement, which were previously implemented based on IRD's administrative rules.

Effective dates are as follows:

Provisions relating to	Effective dates
Transfer pricing (except for section 15F and section 50AAK), relief consequential on transfer pricing adjustment, advance pricing arrangement, tax credit and profits tax concessions	Tax payable beginning on or after 1 April 2018
CbC reporting	An accounting period beginning on or after 1 January 2018
Master file and local file	An accounting period beginning on or after 1 April 2018
Section 15F – Taxation of income derived from intellectual property by non-resident associates	Year of assessment beginning on or after 1 April 2019
Section 50AAK – Attribution of income or loss to a permanent establishment constituted by a non-HK resident person in Hong Kong	Year of assessment beginning on or after 1 April 2019

Country-by-Country Reporting – Notification Deadline

A Hong Kong entity of a reportable group is required to give a notification in relation to CbC reporting for an accounting period beginning on or after 1 January 2018.

If the first accounting period for which the Hong Kong entity has to give the notification ('first accounting period') begins on 1 January 2018, the notification deadline will be 31 March 2019. However, the IRD recognizes that the Hong Kong entity and the service provider may need more time to get familiar with the requirements and procedures for giving the notification. Hence, the notification deadline will be 16 May 2019.

The above treatment only applies to the first accounting period beginning on 1 January 2018. If the first accounting period begins after 1 January 2018, the deadline is three months after the relevant accounting year-end date.

**Section 5
Page 844**

Replace the second paragraph in section 5 on page 844 with the following:

In order to enhance Hong Kong as an investment platform and a gateway for inbound and outbound investments, Hong Kong has accelerated its treaty negotiations with other jurisdictions. As of 1 June 2019, Hong Kong has concluded comprehensive double taxation agreements with 40 jurisdictions including Belgium, Thailand, the mainland of China, Luxembourg, Vietnam, Brunei, the Netherlands, Indonesia, Hungary, Kuwait, Austria, the United Kingdom, Ireland, Liechtenstein, France, Japan, New Zealand, Switzerland, Portugal, Spain, the Czech Republic, Malta, Jersey, Malaysia, Mexico, Canada, Italy, Guernsey, Qatar, Korea, South Africa, United Arab Emirates (UAE), Romania, Russia, Latvia, Belarus, Pakistan, Saudi Arabia, India and Finland.

Modify the table in section 5 on page 844 as follows:

Country	CDTA/ Protocol	Gazetted	Came into force	Take effect
Latvia	CDTA	30 June 2017	24 Nov 2017	Y/A 2018/19
Belarus	CDTA	30 June 2017	30 Nov 2017	Y/A 2018/19
Pakistan	CDTA	30 June 2017	24 Nov 2017	Y/A 2018/19
New Zealand	2nd Protocol	6 Oct 2017	9 Aug 2018	9 Aug 2018
Saudi Arabia	CDTA	8 May 2018	1 Sept 2018	Y/A 2019/20
India	CDTA	4 Sept 2018	30 Nov 2018	Y/A 2019/20
Finland	CDTA	4 Sept 2018	30 Dec 2018	Y/A 2019/20

**Appendix 1
Page 856**

Add the following to Appendix 1 'Summary of avoidance of double taxation agreements' on page 856:

DTA with Hong Kong	Withholding tax charged by the host country			Taxing right of the host country		Taxing right of capital gain on disposal of shares of	
	Dividend	Interest	Royalty	Shipping income	Airline income	Company's assets >50% are immovable property	Other companies
Saudi Arabia	5% ^(xvi)	0% ^(xvi)	5%/8% (xvi)	Exempted	Exempted	Both	< 10% Shareholding: Home country 10% or more: Both
India	5% ^(xvi)	0%/10% (xvi)	10% ^(xvi)	Exempted	Exempted	Both	Both
Finland	5%/10% (xvi)	0% ^(xvi)	3% ^(xvi)	Exempted	Exempted	Both	Home country

Chapter 13 Overview of China tax system
**Section 5
Page 874**
Add the following after the last paragraph of 'Topic highlights':

The Provisional Regulations on Business Tax of the People's Republic of China was repealed by the State Council on 30 October 2017. Business Tax has ceased to be imposed since then.

Delete section 5.1, 6 and 7 from pages 874 to 875.

**Section
10.1.1
Page 879**
Add the following after the last paragraph in section 10.1.1 on page 879:

The above-mentioned thresholds were valid up to 30 April 2018.

Starting from 1 May 2018, if the annual taxable turnover of a taxpayer is not more than RMB5 million, the taxpayer is treated as a small-scale taxpayer. The type of activities carried out by the taxpayer is irrelevant in determining this status (*Caishui [2018] No. 33*).

**Section 11.1
Section 11.2
Page 880**
Add the following after the last paragraph in section 11.1 and after the last paragraph of section 11.2 on page 880:

The basic rate of 17% was valid up to 30 April 2018.

Starting from 1 May 2018, the basic rate is reduced from 17% to 16% (*Caishui [2018] No. 32*).

**Section 11.3
Page 881**
Add the following after the last paragraph in section 11.3 on page 881:

'The Exemption, Deduction and Refund method' is adopted to calculate the export VAT refund.

Different products have different export VAT refund rates depending on the HS code of the export products.

Starting from 15 September 2018, the PRC tax authorities have increased the applicable export VAT refund rates for around 400 products including multi-component integrated circuits, certain electrical appliances, books and newspapers (*Caishui [2018] No. 93*).

**Section 11.4
Page 881**
Add the following after the last paragraph in section 11.4 on page 881:

Effective from 1 July 2014, a tax rate of 3% is applicable to small-scale taxpayers in most cases.

**Section 13.2
Page 882**
Add the following after the paragraph in section 13.2 on page 882:

Starting from 1 July 2017, general VAT taxpayers who purchase goods or taxable labour services can apply for input tax credit when the electronically-produced VAT invoice has been verified by the tax authority within 360 days from the date the invoice is issued.

Prior to Year 2018, input VAT credit that cannot be utilized in the current period can only be carried forward to the following periods. However, starting from Year 2018, if the quantum of input VAT is more than the quantum of output VAT for a period, the excessive input VAT can be refunded.

This input VAT credit refund is only applicable to 19 industries including manufacturing industries involving advanced technology, modern services sectors, power grid industry etc (*Caishui [2018] No. 70*).

Section 14.1
Page 887

Add the following after the last paragraph of section 14.1 on page 887:

Caishui [2017] No. 56

Caishui [2017] No. 56 was promulgated on 30 June 2017 to clarify VAT issues in connection with the asset management sector.

Caishui [2017] No. 56 became effective from 1 January 2018.

VAT taxable activities during the operating period of asset management products are temporarily subject to VAT using the simplified method at a rate of 3% starting from 1 January 2018.

VAT taxable activities conducted during the operation of asset management products prior to 1 January 2018 would not be subject to VAT.

Changes in VAT rates

The basic rate of 17% and the VAT rate of 11% were valid up to 30 April 2018.

Starting from 1 May 2018, the basic rate is reduced from 17% to 16% whilst the transactions which were previously subject to VAT at 11% would be subject to a reduced VAT rate of 10% (*Caishui [2018] No. 32*).

Starting from 1 April 2019, the applicable VAT rate for the manufacturing sector, leasing of movable properties, import, processing, repair and replacement services is further reduced from 16% to 13%. The applicable VAT rate for transportation and construction industries, sales of immovable properties, transfer of land use right, leasing of immovable properties, postal services and basic telecommunication services is further reduced from 10% to 9% (*Public Notice [2019] No. 15*).

Table of taxable consumer goods
Page 889

Modify the following in the table of taxable consumer goods on page 889:

Taxable items	Tax unit	Tax rate/amount
Modify 'Cosmetics' to 'High-end Cosmetics'		15%

Example 2
Page 891

Replace Example 2 and its Solution on page 891 by the following:



Example 2: Calculation of consumption tax liability

A high-end cosmetics manufacturer is a general taxpayer of VAT. It sold high-end cosmetics products to a shopping mall on 10 August 2018 and issued a special VAT invoice. The sales price (excluding VAT) is RMB 400,000 and the output VAT is RMB 64,000. The manufacturer also sold high-end cosmetics products to another company at a sales price of RMB 58,000 (including VAT), and issued a general invoice on 15 August 2018.

Required

Calculate the CT liability on the above businesses of the cosmetics manufacturer in August 2018.

The applicable VAT rate for August 2018 is 16%.

Solution

CT rate for high-end cosmetics products is 15%.

The taxable sales amount of cosmetics products = RMB [400,000 + 58,000 ÷ (1 + 16%)] = RMB 450,000.

CT payable = 450,000 × 15% = RMB 67,500.

Topic highlights Page 894

Replace the Topic highlights on page 894 by the following:

On 31 August 2018, a revised IIT Law ('IITL') was passed by the PRC National People's Congress. The revised IITL became effective on 1 January 2019.

The revised Individual Income Tax Implementation Rules ('IITIR') was promulgated on 18 December 2018.

There are nine categories of taxable income.

Section 21.1 Page 894

Add the following after the last paragraph in section 21.1 on page 894:

The revised IITL introduced the '183-day' threshold in determining a PRC tax resident and a non-PRC tax resident.

If an individual, who are without domicile in China, is present in the PRC for 183 days or more in a calendar year (hereafter referred to as the '183-day period'), he/she would be treated as a PRC tax resident and subject to IIT on his/her worldwide income.

If an individual, who are without domicile in China, is present in the PRC for not more than 183 days in a calendar year, he/she would be treated as a non-PRC tax resident and subject to IIT on his/her PRC-sourced income.

Section 21.3 Page 895

Replace section 21.3 on page 895 by the following:

The following nine categories of income are subject to IIT:

- Employment income (i.e. wages and salaries);
- Remuneration for labour services such as the provision of design, accounting, legal services etc;
- Author's remuneration;
- Royalties;
- Business operation income derived by individual entrepreneurs operating businesses;
- Interest, dividends, and profit distribution;
- Rental income;
- Income from transfer of property;
- Contingency income such as awards or other 'windfall' income

For PRC tax residents, employment income, remuneration for labour services, author's remuneration and royalties are combined as 'Comprehensive Income' for aggregate tax calculation purpose on an annual basis.

The payers to PRC tax residents are required to file monthly provisional returns and withhold and make monthly provisional payments. The PRC tax residents are required to perform annual reconciliation filing from 1 March to 30 June after the end of the relevant calendar year. Income from the other categories is taxed separately by category on a monthly or transaction basis.

For non-PRC tax residents, income from the above nine categories is taxed separately on a monthly or transaction basis.

Each income category has its own tax rate(s), allowable deductions etc.

Section 21.4
Page 895

Replace the first sentence in section 21.4 on page 895:

Out of the nine categories of taxable income, this section will focus on employment income.

Section 21.4.1
Page 895

Add the following after the first paragraph in section 21.4.1 on page 895:

If an individual is not domiciled in the PRC and was present in the PRC for not more than 90 days in a calendar year, he/she would be exempt from paying IIT on their employment income except the portion of income which is borne or deemed to be borne by any PRC enterprises or a permanent establishment which the employer has in the PRC (Revised IITIR, *Article 5*).

Section 21.4.2
Page 896

Replace the caption and the first two paragraphs in section 21.4.2 on page 896 by the following:

21.4.2 Non-PRC tax residents who reside in the Mainland for more than 183 days in a calendar year (but such situation does not occur for six or more consecutive years)

A non-PRC tax resident who resides in the PRC for more than 90 days in a calendar year (or more than 183 days in any 12-month period if the respective tax treaty applies) would be subject to IIT on employment income derived during their 'actual working days in the PRC'.

They would be subject to IIT on their PRC-sourced income plus any non-PRC sourced income which is paid to them by a PRC enterprise or is borne by a PRC enterprise.

The portion of non-PRC sourced income which is not paid by a PRC enterprise and not borne by any PRC enterprise is exempt from paying IIT (Revised IITIR, *Article 4*)

Section 21.4.3 & 21.4.4
Pages 896 and 897

Delete section 21.4.3 on page 896 and section 21.4.4 on pages 896 and 897 and replace by the following:

21.4.3 Non-PRC tax residents who reside in the Mainland for more than 183 days in a calendar year for six consecutive years

Once a non-PRC tax resident resides in the PRC for more than 183 days in a calendar year for six consecutive years, he/she would be subject to IIT on his/her worldwide income starting from the sixth year.

However, if such an individual does not reside in the PRC for 183 days or more in any subsequent year, he/she would be subject to IIT only on his/her PRC-sourced income for that year.

If the individual has an absence from the PRC in a single trip for more than 30 days in any calendar year, the counting of the number of consecutive years would restart and be counted again. (Revised IITIR, *Article 4*).

Section 21.5
Page 897

Replace the first two paragraphs in section 21.5 on page 897:

The revised IITL became effective from 1 January 2019. However, the new IIT tax rate table for employment income and other Comprehensive Income became effective from 1 October 2018. Please see the tax rate table below.

Starting from 1 October 2018, the monthly statutory deduction is increased to RMB 5,000 per month (i.e. RMB60,000 per year). There is no more step-up deduction (previous RMB1,300) for non-PRC tax resident.

Starting from 1 January 2019, the following specific additional deductions can be claimed and deducted by PRC tax residents from their Comprehensive Income to arrive at the taxable income:

- Dependent children's education;
- Continuing education;
- Serious illness medical treatment;
- Housing mortgage interest and rental;
- Elderly care expenses

The implementation rules for specific additional deductions are stipulated in *Guofa (2018) No. 41*.

Salient points are as follows:

- (1) Any unutilized specific additional deductions in a tax year cannot be carried forward.
- (2) Dependent children's education – a monthly deduction of RMB1,000 (capped) for each child who attend a full-time education. The university or colleges can either be located in the PRC or outside the PRC. Proper documentation should be substantiated.
- (3) Continuing education – a monthly deduction of RMB400 (capped). The maximum deduction period for a specific education programme is 48 months.
- (4) Serious illness medical treatment – a deduction of RMB80,000 per annum (capped) for the portion of medical expenses exceeding RMB15,000 actually borne by the taxpayer (i.e. after reduction of any medical insurance reimbursement).
- (5) Housing mortgage interest – a deduction of housing mortgage interest expenses of RMB1,000 per month (capped) for the first residential property mortgage loan. The maximum deduction period is 240 months.
- (6) Rental expenses – a taxpayer can claim a deduction of rental expenses incurred in the primary working city of RMB1,500 per month (capped) if the taxpayer has no residential property and the primary working city is located in a capital city of a province, a municipality directly administered by the State Council, and other cities designated by the State Council.

For cities other than the above, the monthly deduction is capped at RMB1,100 if the primary working city has at least one million registered households, and capped at RMB800 if it has less than one million registered households.
- (7) Elderly care expenses – a taxpayer can claim a deduction of elderly care expense. Irrespective of the number of dependents, the monthly deduction is RMB2,000 (capped) if the taxpayer is the only child and RMB1,000 (capped) if the taxpayer is not the only child. Elderly care expenses are incurred for dependant parents aged 60 or above.

Replace the tax rate table in section 21.5 on page 897:

Monthly taxable income (without gross up)	Tax rate	Quick calculation deduction
RMB		RMB
Up to 3,000	3%	0
3,001 to 12,000	10%	210
12,001 to 25,000	20%	1,410
25,001 to 35,000	25%	2,660
35,001 to 55,000	30%	4,410
55,001 to 80,000	35%	7,160
80,001 and above	45%	15,160

Add the following under the tax rate table in section 21.5 on page 897:

The above tax rate table applies to the Comprehensive Income of PRC tax residents, and employment income of non-PRC tax residents.

Interests, dividends, profit distribution, rental income, income from transfer of property and contingency income are subject to a tax rate of 20%.

Replace the formula before Example 4 in section 21.5 on page 897 with the following:

Taxable monthly employment income × applicable tax rate – quick calculation deduction

Taxable monthly employment income

= Monthly employment income – monthly standard deduction – monthly specific additional deductions

**Example 4
Section 21.5
Page 897****Replace Example 4 in section 21.5 on page 897 by the following:****Example 4**

Mr. A is a non-PRC tax resident. His monthly employment income is RMB100,000 and he bears his own IIT liability. His monthly IIT liability is calculated as follows:

IIT payable = [(RMB 100,000 – RMB 5,000 (monthly standard deduction)) × 45%] – RMB 15,160

= RMB 27,590

Note. For ease of illustration, assumed there are no other allowable deductions.

Example 5
Section 21.5
Page 898

Replace Example 5 in section 21.5 on page 898 by the following:



Example 5

Using the same information in the above example, if Mr. A's IIT liability is borne by his employer, his IIT liability is calculated as follows:

Gross-up taxable income

$$= (\text{RMB } 100,000 - \text{RMB } 5,000 - \text{RMB } 15,160) / (1 - 45\%)$$

$$= \text{RMB } 145,164$$

IIT payable (borne by the employer)

$$= \text{RMB } 145,164 \times 45\% - \text{RMB } 15,160$$

$$= \text{RMB } 50,164$$

Note. For ease of illustration, assumed there are no other allowable deductions.

Section 21.7
Page 899

Replace the second, third and fourth paragraphs in section 21.7 on page 899:

For PRC tax residents, employment income, remuneration for labour services, author's remuneration and royalties are combined as 'Comprehensive Income' for aggregate tax calculation purpose on an annual basis.

Generally speaking, the employer (i.e. the payer of employment income) should act as the withholding agent to file monthly provisional returns and withhold monthly provisional payments. Monthly provisional filings and monthly provisional payments should be performed within 15 days after the end of each month.

The PRC tax residents are required to perform annual reconciliation filing from 1 March to 30 June after the end of the relevant calendar year.

Income from the other categories is taxed separately by category on a monthly or transaction basis.

For non-PRC tax residents, income from the above nine categories is taxed separately on a monthly or transaction basis.

New section
21.8
Page 899

Add a new section 21.8 after section 21.7 on page 899.

21.8 General Anti-avoidance Rule (GAAR) for individuals

The revised IITL introduced General Anti-avoidance Rule (GAAR) for individuals.

The PRC tax authorities are empowered to assess tax on individuals who are involved in the following transactions:

- Business transactions which are not conducted at arm's length
- Tax avoidance by use of offshore tax haven
- Obtain tax benefits through arrangements without commercial substance

Section 22.2.1 Page 900	Add the following at the end of the last fifth paragraph in section 22.2.1 on page 900:
	<p>Starting from 1 January 2018, the deduction threshold of employee's education expenses has been increased from 2.5% to 8%.</p>
	Add the following circular at the end of the last fourth paragraph of section 22.2.1 on page 900, in connection with charitable donations:
	<p><i>(Caishui [2018] No. 15)</i></p>
	Add the following at the end of the second last paragraph in section 22.2.1 on page 900:
	<p>For the period from 1 January 2017 to 31 December 2019, qualified technology-based small and medium enterprises are eligible for super R&D deduction up to 175% of actual expenses incurred. (<i>Caishui [2017] No. 34</i>)</p>
Section 22.2.1 Page 901	Add the following before the caption 'Preferential CIT treatments for Hengqin, Qianhai and Pingtan' on page 901:
	<p>Starting from 1 January 2018, qualified HNTes and technology-based small and medium enterprises can utilize tax losses to set off against future taxable profits for at most ten years provided that the required conditions are met.</p>
	<p>Starting from 1 January 2018, qualified technologically-advanced service companies are subject to CIT at a reduced rate of 15% (<i>Caishui [2018] No. 44</i>).</p>
	<p>For the period from 1 January 2018 to 31 December 2020, small-scale enterprises with an annual taxable profits of not more than RMB1 million would be subject to 50% of the original CIT rate (20%). The effective CIT rate becomes 10% (<i>Caishui [2018] No. 77 and Public Notice [2018] No. 40</i>).</p>
Section 22.2.3 Page 902	Remove the last paragraph of section 22.2.3 on page 902 and add the following:
	Deferral of withholding tax on direct re-investment
	<p>On 21 December 2017, the Ministry of Finance, the SAT, the National Development and Reform Commission and the Ministry of Commerce jointly issued <i>Caishui [2017] No. 88</i>.</p>
	<p>Dividends derived by non-resident investors from China are subject to a PRC withholding tax of 10% unless such rate can be reduced by the applicable double taxation agreements. <i>Caishui [2017] No. 88</i> sets out the tax deferral treatment and encourages the non-resident investors to make direct re-investment to China.</p>
	<p><i>Caishui [2017] No. 88</i> clarifies the criteria to enjoy tax deferral treatment, application procedures and responsibilities, and post-administration by the tax authorities.</p>
	<p><i>Caishui [2017] No. 88</i> would be effective retrospectively from 1 January 2017, and tax payments already settled on eligible re-investment can be refunded.</p>
Section 22.3.1 Page 902	Add the following after the last paragraph under 'Annual filing obligation' in section 22.3.1 on page 902:
	<p>The SAT promulgated <i>Public Notice [2017] No. 54</i> at the end of December 2017 introducing a new version of annual CIT return and the explanatory notes for completing the forms. <i>Public Notice [2017] No. 54</i> took effect from 1 January 2017 and shall apply to the annual CIT filing for 2017 and onwards.</p>

The new package has been designed according to the new tax policies released since 2014. The new package is composed of 37 forms, including one basic information form, one lead return and 35 schedules.

Compared with the 2014 annual CIT return package, the overall structure of the new package has not changed significantly. The new package demonstrates the principle of 'simplified forms, optimized structure and facilitating reporting'. This demonstrates the tax authorities' principle of strengthening information collection and post-filing supervision.

**Section
22.3.2
Page 903**

Add the following after the last paragraph of section 22.3.2 on page 903:

The SAT promulgated *Public Notice [2017] No. 37* which became effective from 1 December 2017. According to *Public Notice [2017] No. 37*, the withholding obligation on dividend payment shall arise when the dividend payment is actually made.

Public Notice [2017] No. 37 also stipulated that when the payer (i.e. the withholding agent) fails to withhold taxes, the recipient (i.e. the non-PRC tax resident) should perform self-reporting and pay the related taxes to the tax authority.

**Section
22.5.1
Page 905**

Replace the following phrase in section 22.5.1 on page 905:

Replace *Public Announcement No. 30* with *Public Notice [2012] No. 30*.

Add the following after the last paragraph of section 22.5.1 on page 905:

The SAT released *Public Notice [2018] No. 9* on 3 February 2018 which abolished *Guoshuihan [2009] No. 601* and *Public Notice [2012] No. 30*.

Public Notice [2018] No. 9 made changes to unfavourable factors stated in *Guoshuihan [2009] No. 601*.

Public Notice [2018] No. 9 tightened the first two unfavourable factors, deleted the third and the fourth factors and retained the fifth to seventh factors stated in *Guoshuihan [2009] No. 601*.

The salient points of the above changes are as follows:

- The first unfavourable factor – The applicant has the obligation to pay more than 50% (the original threshold was 60% in *Guoshuihan [2009] No. 601*) of the income within 12 months following the receipt of the income to a third jurisdiction tax resident.
- The second unfavourable factor – The applicant does not carry out substantive business activities. Whether an applicant's business activities are 'substantive' shall be assessed based on the function performed and risk undertaken by the applicant. Substantive business activities include manufacturing, trading and management activities as well as investment and management activities.

The explanatory notes to *Public Notice [2018] No. 9* provide guidance on the definition of investment and management activities including project analysis, pre-investment research, investment decision, execution, post-investment management, industry analysis, market research, regional headquarters function, treasury function, financing function, etc.

- The third and the fourth unfavourable factors in *Guoshuihan [2009] No. 601* are deleted as their assessment criteria have been incorporated into the new interpretation of the second unfavourable factor.

The above changes will pose challenges to some non-resident taxpayers as their treaty benefits may be denied for the lack of beneficial ownership.

Nevertheless, *Public Notice [2018] No. 9* has brought the following two major changes for claiming of tax treaty benefits on dividends:

- Extended the safe harbor rule with respect to dividends of listed companies to also cover governments and individuals who are tax residents of a tax treaty jurisdiction; or a company, directly or indirectly, wholly owned by the listed company, the aforementioned government or individuals; and
- Qualified treaty benefit applicants may apply a 'same jurisdiction/same treaty benefit rule' under multi-tier holding structures.

'Same jurisdiction rule' – The shareholder, which directly or indirectly holds 100% equity interest of the applicant, qualifies as a beneficial owner under *Public Notice [2018] No. 9* and the aforementioned shareholder and the applicant are tax residents of the same tax jurisdiction.

'Same treaty benefit rule' – The shareholder, which directly or indirectly holds 100% equity interest of the applicant, qualifies as a beneficial owner under *Public Notice [2018] No. 9* and such shareholder and all the intermediate shareholders in the multi-tier holding structure are tax residents from a jurisdiction which enjoys the same or better treaty benefits in connection with dividends received as compared to that which the applicant is entitled to.

The above changes will increase non-resident taxpayers' chances of enjoying treaty benefits on dividends.

Public Notice [2018] No. 9 takes effect from 1 April 2018 and *Guoshuihan [2009] No. 601* and *Public Notice [2012] No. 30* are then abolished.

**Section
22.5.2
Page 906**

Replace the following phrase in the last paragraph of section 22.5.2 on page 906:

Replace *Public Announcement [2015] No. 7* with *Public Notice [2015] No. 7*.

Add the following after the last paragraph of section 22.5.2 on page 906:

Public Notice [2015] No. 7 also stipulated that the payers (i.e. the transferee), without distinguishing whether they are PRC tax resident enterprises or non-PRC resident enterprises, have a withholding obligation on PRC taxes arising from indirect equity transfers.

**Notes
Page 908**

Replace the last two paragraphs of 'Notes for VAT reform programme' by the following:

Starting from 1 May 2016, all types of services are subject to VAT instead of Business Tax.

Answer 3
Page 909

Replace Answer 3 on page 909 by the following:

Monthly Taxable income = RMB(20,000 – 5,000) = RMB15,000

Note. For ease of illustration, assumed there are no other allowable deductions.

Progressive tax rates on taxable income from wages and salary (without gross-up)

Monthly taxable income (without gross up)	Tax rate	Quick calculation deduction
RMB		RMB
Up to 3,000	3%	0
3,001 to 12,000	10%	210
12,001 to 25,000	20%	1,410
25,001 to 35,000	25%	2,660
35,001 to 55,000	30%	4,410
55,001 to 80,000	35%	7,160
80,001 and above	45%	15,160

Monthly IIT liability

= RMB (15,000 × 20% – 1,410)

= RMB 1,590

