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SUPPLEMENT

Qualification Programme

# Module D

# Taxation



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

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## Changes at a glance

Amended on Learning Pack		Supplement
Chapter Name		Page
<b>Identified Errata</b>		
3	Hong Kong profits tax	1
8	Hong Kong stamp duty	1
13	Overview of China tax system	1
<b>Technical Updates</b>		
	Tax tables	2
1	The tax system in Hong Kong	3
2	Administration procedures under the Inland Revenue Ordinance	6
3	Hong Kong profits tax	8
4	Non-resident persons	11
5	Hong Kong salaries tax	23
6	Hong Kong property tax	24
7	Personal assessment	24
8	Hong Kong stamp duty	24
9	Introduction to tax planning	24
10	Tax investigation and field audit	24
11	Tax compliance and tax advisory services	25
12	Double taxation arrangement and agreements	25
13	Overview of China tax system	28

## Introduction

This Supplement is to be used in conjunction with the fifth edition of the Learning Pack, and it will bring you fully up to date for developments that have occurred in the period since publication of the Learning Pack up to 31 May 2016, the cut-off date for examinable contents for the December 2016 and June 2017 examinations.

The Supplement comprises a technical update on developments that will be examinable in December 2016 and June 2017 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!

HKICPA Qualification Programme  
Module D Learning Pack

**Part A: Identified Errata**

**Chapter 3 Hong Kong profits tax**

**Section 8.5.8** Revise the paragraphs (b) and (c) under 'Escape clause in ss.16EC(5) and (6)' as below:

**Pages 184 to 185**

- (b) The relevant right was purchased by the end-user from the supplier on or after the new law becomes operational (s.16EC(5)(b)); and
- (c) No deduction under s.16E or 16EA has been allowed to the end-user in respect of the relevant right before (s.16EC(5)(c)).

**Example 81** Replace the last paragraph with the following:

**Page 232** 'As four months' profits would have dropped out of assessment, the IRD will likely re-compute the assessable profits for the year preceding the year of change (2013/14); and profits for the period from 1/7/2012 to 31/10/2012 would drop out of assessment.'

**Chapter 8 Hong Kong stamp duty**

**Example 16** Revise the second last paragraph of the answer as below:

**Page 524** As Mr. N is a non-HKPR, BSD is payable on the AFS under Head1(1C) at 15% on the full value of \$6 million, regardless of the non-HKPR's share of interest. The amount of BSD payable is \$900,000.

**Chapter 13 Overview of China tax system**

**Section 9.2** Revise the seventh bullet point as below:

- Using self-manufactured goods, processed goods for collective welfare or personal consumption

**Answer 3 in 'Answers to self-test questions'** Revise the answer as below:

**Page 828** Distributing purchased goods to shareholders is treated as deemed sales for VAT purpose. Awarding a purchased car to a salesman is also treated as deemed sales (i.e. using purchased goods as free gifts) for VAT purpose. The sales amount of company for VAT is:  $\text{RMB } 130,000 \times (4 + 1) = \text{RMB } 650,000$ .

## Part B: Technical Updates

### Tax tables

**Page xix** Replace the last paragraph on page xix (after the Tax Table for Salaries Tax and Personal Assessment) with the following:

For 2015/16, 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 (enacted on 27 May 2016).

For 2014/15, 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.

**Page xxiii** Add the following on page xxiii under the Tax Table for Personal Allowances:

The following changes will become effective from the year of assessment 2016/17:

- Increase basic allowance from \$120,000 to \$132,000
- Increase married person's allowance from \$240,000 to \$264,000
- Increase single parent allowance from \$120,000 to \$132,000
- Increase basic dependent parent/grandparent allowance (aged 60 or above) from \$40,000 to \$46,000 each
- Increase additional dependent parent/grandparent allowance (aged 60 or above) from \$40,000 to \$46,000 each
- Increase basic dependent parent/grandparent allowance (aged between 55 and 59) from \$20,000 to \$23,000 each
- Increase additional dependent parent/grandparent allowance (aged between 55 and 59) from \$20,000 to \$23,000 each
- Increase the deduction ceiling of elderly residential care expenses from \$80,000 to \$92,000

Delete the following note on page xxiii (after the Tax Table for Personal Allowances)

**Note:** Proposed changes in child allowance in 2015/16 Budget (not yet enacted)

## Chapter 1 The tax system in Hong Kong

**Section 1.3** Modify the table in Section 1.3 on page 6 as follows:

**Page 6**

Country	CDTA/ Protocol	Gazetted	Came into force	Take effect
Italy	CDTA	4 Oct 2013	10 Aug 2015	Y/A 2016/17
Korea	CDTA	17 Oct 2014	Pending	Pending
South Africa	CDTA	15 May 2015	20 Oct 2015	Y/A 2016/17
UAE	CDTA	15 May 2015	10 Dec 2015	Y/A 2016/17
Mainland of China	4 <sup>th</sup> Protocol	2 Oct 2015	29 Dec 2015	29 Dec 2015
Romania	CDTA	13 May 2016	Pending	Pending
Russia	CDTA	13 May 2016	29 Jul 2016	Y/A 2017/18
Latvia	CDTA	Pending	Pending	Pending

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

**Pages 15 and  
17**

A list of DIPNs issued/revised by the IRD (as at 1 June 2016) is as follows:

No.	Subjects	Date of issue
43 (Revised)	Profits Tax – Profits Tax Exemption for Offshore Funds	May 2016
51	Profits Tax Exemption for Offshore Private Equity Fund	May 2016

**Section 5.2** Replace the last paragraph of Section 5.2 on page 21 with:

**Page 21**

There is a partial tax reduction for 2014/15 as a relief measure as per the 2015/16 Budget. All taxpayers liable to profits tax, salaries tax or tax under personal assessment will have a reduction of 75% of the 2014/15 final tax, subject to a ceiling of \$20,000 per case.

There is a partial tax reduction for 2015/16 as a relief measure as per the 2016/17 Budget. All taxpayers liable to profits tax, salaries tax or tax under personal assessment will have a reduction of 75% of the 2015/16 final tax, subject to a ceiling of \$20,000 per case (enacted on 27 May 2016).

**Section 7.3** Replace Section 7.3 on page 24 with:

**Page 24**

7.3 Amendments proposed by the 2016–17 Budget

Under the 2016/17 Budget, the following tax measures were proposed (enacted on 27 May 2016):

- Reduce profits tax, salaries tax and tax under personal assessment for 2015/16 by 75%, subject to a ceiling of \$20,000 per case.
- Increase basic allowance to \$132,000 from 2016/17 onwards.
- Increase married person's allowance to \$264,000 from 2016/17 onwards.

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- Increase single parent allowance to \$132,000 from 2016/17 onwards.
  - Increase basic dependent parent/grandparent allowance (aged 60 or above) from \$40,000 to \$46,000 each from 2016/17 onwards.
  - Increase additional dependent parent/grandparent allowance (aged 60 or above) from \$40,000 to \$46,000 each from 2016/17 onwards.
  - Increase basic dependent parent/grandparent allowance (aged between 55 and 59) from \$20,000 to \$23,000 each from 2016/17 onwards.
  - Increase additional dependent parent/grandparent allowance (aged between 55 and 59) from \$20,000 to \$23,000 each from 2016/17 onwards.
  - Increase the deduction ceiling of elderly residential care expenses from \$80,000 to \$92,000 from 2016/17 onwards.
  - Expand the scope of tax deduction for capital expenditure incurred for the purchase of intellectual property rights from five categories to eight. The additions are layout design of integrated circuits, plant varieties and rights in performance.
  - A rate waiver for all four quarters, subject to a cap of HKD1,000 per quarter, for each rateable property.
- 

**Section 7.9** Add the following at the end of the third paragraph of Section 7.9 on page 28:

**Page 28** The exchange of notes between Hong Kong and Japan entered into force from 6 July 2015.

The Inland Revenue (Amendment) Bill 2016 (the 'Bill') was gazetted on 8 January 2016. The Bill seeks to put in place a legal framework to implement the new international standard for automatic exchange of financial account information in tax matters ('AEOI') as promulgated by OECD.

Under the AEOI standard, a financial institution is required to identify financial accounts held by tax residents of jurisdictions with which Hong Kong has entered into an AEOI arrangement. Financial institutions are required to collect the reportable information of these financial accounts, and furnish such information to the IRD. The IRD will exchange it with the tax authorities of AEOI partner jurisdictions on an annual basis.

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**Section 7.10** Replace the fourth paragraph of Section 7.10 on page 28 with the following:

**Page 28** On 17 July 2015, the Government published in the Gazette the Inland Revenue (Amendment) (No.2) Ordinance 2015, which seeks to extend profits tax exemption for offshore funds to private equity funds. Transactions conducted by offshore private equity funds in respect of securities of eligible overseas portfolio companies will be able to enjoy profits tax exemption.

Under the Amendment Ordinance, to qualify for profits tax exemption, offshore private equity funds must carry out specified transactions through corporations licensed by the Securities and Futures Commission, or they must fulfill the following conditions:

- (a) They have more than four investors;
  - (b) The capital commitment made by investors must exceed 90% of aggregate capital commitments; and
-



- (c) The portion of net proceeds arising from the fund's transactions to be received by the originator must not exceed 30%.

To prevent abuse by local companies by simply converting their taxable profits to non-taxable income via an offshore fund structure, an eligible portfolio company should be a non-Hong Kong incorporated private company, and it must not hold any Hong Kong properties or carry out any business in Hong Kong within a stipulated time limit.

Furthermore, the existing deeming provisions, which provide that a resident person holding a beneficial interest of 30% or more in a tax-exempt private equity fund will be deemed to have derived assessable profits in respect of profits earned by the fund in Hong Kong, will equally apply to offshore private equity funds.

Refer to newly added Section 2.8.4 of Chapter 4 on page 14 of this Supplement for details.

Please note that DIPN 51 was issued in May 2016 to set out IRD's interpretation and practice in relation to the relevant provisions under the Inland Revenue (Amendment) (No.2) Ordinance 2015. References should also be made to DIPN 43 (Revised in May 2016) since it covers the interpretation and practice relating to the offshore fund regime as a whole.

**Section 7.11** Add Section 7.11 on page 28:

**Page 28** 7.11 Corporate Treasury Centre

The Inland Revenue (Amendment) (No.4) Bill 2015 was gazetted on 4 December 2015 which included the following:

- (a) Introduce a concessionary profits tax rate of 8.25% (50% of the prevailing profits tax rate of 16.5%) for certain profits derived by a qualifying corporate treasury centre in Hong Kong;
- (b) Enhance the interest expense deduction provisions for an intra-group financing business carried on by a corporation in Hong Kong;
- (c) Deem the interest income and certain profits derived from the intra-group financing business as taxable trading receipts; and
- (d) Clarify the profits tax and stamp duty treatments in respect of regulatory capital securities issued by financial institutions in compliance with Basel III capital adequacy requirements.

The Bill will be subject to the approval of the Legislative Council before enacting into law. Once enacted, the provisions on the concessionary tax rate applicable to corporate treasury centres and the new interest expense deduction provisions for intra-group financing business are expected to apply from 1 April 2016.

**Appendix**  
**Page 29**

Modify the following for 'Business Tax' on page 29 (Appendix – General comparison of HKSAR and PRC tax systems):

	<b>HKSAR</b>	<b>Mainland, PRC</b>
Business Tax	None	<p>3%, 5% or 5% to 20% on revenue from provision of services, transfer of intangible assets and sale of immovable property situated in the PRC.</p> <p>Since 1 August 2013, China has kicked off the national implementation of the VAT reform programme. For example, provision of transportation services, modern services and telecommunication services are now subject to VAT instead of BT. Refer to Chapter 13 for details.</p> <p>Furthermore, starting from 1 May 2016, VAT reform programme has expanded to cover the sales of immovable properties, leasing of immovable properties and transfer of land use right, leasing of tangible movable properties as well as provision of construction services, financial services and consumer services. Refer to newly added paragraphs under 'Expansion of VAT reform programme' on page 29 of this Supplement for details.</p>

**Chapter 2 Administration procedures under the Inland Revenue Ordinance**

**Section 5** Add the following paragraphs at the end of Section 5 on page 51:

**Page 51** The Inland Revenue (Amendment) (No. 3) Ordinance 2015 was gazetted on 13 November 2015. The objectives are to enhance the tax appeal mechanism and improve the efficiency and effectiveness of the Board of Review.

The Board of Review is an independent statutory body constituted under the IRO to hear and determine appeals lodged by taxpayers.

The Inland Revenue (Amendment) (No. 3) Ordinance 2015 covers the following four aspects:

- (a) Allow an appeal against the decision of the Board of Review on a question of law to go direct to the Court of First Instance or, if applicable, the Court of Appeal. This abolishes the present case stated procedure under the Board of Review, which is not only time-consuming and costly, but also affects the capacity of the Board of Review to hear other appeals;
- (b) Empower the person presiding at the hearing of an appeal before the Board of Review to give directions on the provision of documents and information for the hearing. This is to address the situation of late submissions from time to time, which has affected the proceedings of the Board of Review and may also lead to rescheduling of hearings;

- (c) Provide privileges and immunities to the Chairman, Deputy Chairmen and other members of the Board of Review, and the parties to a hearing as well as other persons appearing before the Board of Review. This is in line with the arrangement of other statutory appeal boards; and
- (d) Raise the ceiling of costs to be paid by the appellant as may be ordered by the Board of Review from \$5,000 to \$25,000, to strengthen the deterrent effect against frivolous appeals. The current ceiling has not been adjusted since 1993.

**Appendix  
Page 79**

Add the following new case to Appendix – Summary of cases relating to administrative procedures under the IRO (page 79):

Taxpayer [Ref.]	Subject matter	Extract of facts and determination
<p>CIR v Geneharbor (Hong Kong) Technologies Limited [DCTC74/2015]</p>	<p>Objection and holdover</p>	<p>The CIR sued the taxpayer for a sum (together with interest and costs) being tax due and payable, but unpaid, by the taxpayer, under s.75 of the IRO.</p> <p>The taxpayer lodged an objection pursuant to s.64(1) of the IRO against the assessments on the ground the profits assessed were excessive and incorrect.</p> <p>The taxpayer also requested that the tax assessed for the years of assessment 2007/08 and 2008/09 be held-over unconditionally. The Assistant Commissioner issued two notices on 22 April 2014 ordering that the tax be held over with conditions that an equal amount of Tax Reserve Certificate be purchased not later than 6 May 2014.</p> <p>The taxpayer argued that by the operation of s.71(2) of the IRO, since the profit tax has been held over, the due dates of tax dues as pleaded in the statement of claim were not applicable as no profit tax shall be due when they were held over irrespective of whether the taxpayer has satisfied the conditions or not.</p> <p>It was held that none of the above submissions made on behalf of the taxpayer contains any real substance and hence the court has dismissed all of them.</p>

<p>CIR v Gennon Enterprises Limited [DCTC773/2015]</p>	<p>Recovery of additional profits tax payments</p>	<p>The CIR sued the taxpayer for the recovery of additional profits tax payments for the years of assessment 2007/08 and 2008/09 in respect of two offshore companies.</p> <p>The taxpayer applied for a stay of all further proceedings pending the determination of the objections to the Notices of Additional Assessment and Demand for Tax and/or the determination of the appeal, if any, from the Commissioner's determination to the Board of Review.</p> <p>The Judge referred to two critical provisions of the IRO: s.71(2) and s.75 in considering the case.</p> <p>It was held that the taxpayer has put no material, and indeed made no attempt, to address the merits of its objections to the assessments in dispute. The taxpayer simply expressed their disagreement with the view taken by the CIR on the 'agency' issue and did not furnish any grounds or documentary evidence to validate or support their own view.</p> <p>Hence, the court has dismissed the taxpayer's stay application.</p>
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### Chapter 3 Hong Kong profits tax

**Section 4.2.3** Under Section 4.2.3 Purchase and sale of listed securities on page 111, replace the last paragraph with the following:  
**Page 111**

Where a non-resident buys and sells shares in the Hong Kong Stock Exchange either directly or through an agent and makes profits, the profits arise in Hong Kong. However, the non-resident may not be chargeable to profits tax in respect of such profits. S.20AA excludes stockbrokers and approved investment advisers from potential profits tax liability as agents in respect of securities trading and investment profits derived by the non-residents for whom they act, and DIPN 30 (Revised) provides guidance on the application of s.20AA. The Revenue (Profits Tax Exemption for Offshore Funds) Ordinance 2006 exempts offshore funds from profits tax. In July 2015, the Inland Revenue (Amendment) (No. 2) Ordinance 2015 was enacted to extend profits tax exemption for offshore funds to private equity funds. DIPN 43 (Revised) and DIPN 51 were issued in May 2016 to provide guidance to cover the IRD's relevant interpretation and practice on profits tax exemption for offshore funds. (Taxation of non-residents is discussed in Chapter 4.)

**Section 7.3**  
**Page 153** Under Section 7.3 Property and share transactions on page 153, add the following at the end of the first paragraph:

In February 2016, the CFA upheld the COA's decision that there was no change of intention from capital investment to trading up to the period of time within which the taxpayers engaged in various activities to enhance the value of the land for realisation. This is because none of the taxpayers' enhancement activities within that period had gone beyond what might be expected of a non-trade owner in similar circumstances.

**Section 7.3.1**  
**Page 156** Under Section 7.3.1 Tax cases on property and share transactions on page 156, replace the last row with the following:

Taxpayer	Subject matter	Reference
<i>Church Body of the Hong Kong Sheng Kung Hui &amp; Hong Kong Sheng Kung Hui Foundation</i>	Profits on property redevelopment, change of intention, exemption under s.88	HCIA 2 & 3/2009 (2014) CACV 41/2010 (2016) FACV 16/2015

**Section 14.5.3**  
**Page 263** Under Section 14.5.3 Double tax arrangement with other countries on page 263, replace the second 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 2016, Hong Kong has concluded comprehensive DTAs with 35 jurisdictions including Austria, Belgium, Brunei, Canada, the Czech Republic, France, Guernsey, Hungary, Indonesia, Ireland, Italy, Japan, Jersey, Korea, Kuwait, Latvia, Liechtenstein, Luxembourg, the mainland of China, Malaysia, Malta, Mexico, the Netherlands, New Zealand, Portugal, Qatar, Romania, Russia, South Africa, Spain, Switzerland, Thailand, the United Arab Emirates, the United Kingdom and Vietnam.

**Section 14.6.2**  
**Page 268** Under Section 14.6.2 Double tax arrangements on international aviation income on page 268, replace the last paragraph with the following:

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 2016, Hong Kong has signed comprehensive DTAs with 35 jurisdictions including Austria, Belgium, Brunei, Canada, the Czech Republic, France, Guernsey, Hungary, Indonesia, Ireland, Italy, Japan, Jersey, Korea, Kuwait, Latvia, Liechtenstein, Luxembourg, the mainland of China, Malaysia, Malta, Mexico, the Netherlands, New Zealand, Portugal, Qatar, Romania, Russia, South Africa, Spain, Switzerland, Thailand, the United Arab Emirates, the United Kingdom and Vietnam. For details, refer to Chapter 12 Double Taxation Arrangement and Agreements.

**Appendix 2**  
**Page 278**

In Appendix 2 on page 278, for the third last case *Church Body of the Hong Kong Sheng Kung Hui*, replace with the following:

Taxpayer [Ref.]	Subject matter	Board of Review	High Court/ Court of First Instance	Court of Appeal	Privy Council/ Court of Final Appeal
Church Body of the Hong Kong Sheng Kung Hui & Hong Kong Sheng Kung Hui Foundation [HCIA 2 &3/2009] [(2014) CACV 41/2010] [(2016) FACV 16/2015]	Profit on property redevelopment	Taxable	Taxable	Allowed the taxpayer's appeal and remitted the case back to the BOR to determine if a change of intention to trading occurred on a later date	Dismissed the CIR's appeal and remitted the case back to the BOR to determine if a change of intention to trading occurred on a later date
<b>(discussed in App. 13)</b>					

**Appendix 2**  
**Page 278**

In Appendix 2 on page 278, for the last case *Aviation Fuel Supply Company*, replace with the following:

Taxpayer [Ref.]	Subject matter	Board of Review	High Court/ Court of First Instance	Court of Appeal	Privy Council/ Court of Final Appeal
Aviation Fuel Supply Company [(2011) HCIA 6/2009] [(2012) CACV 150/2011]	A lump sum to buy out the right to receive income over the remaining 15 years	–	Not taxable	Not taxable	Not taxable
<b>(discussed in App. 12)</b>					

**Appendix 13** In Appendix 13 on page 304, replace the last row of the table with the following:

**Page 304**

Taxpayer	Subject matter	Reference
<i>Church Body of the Hong Kong Sheng Kung Hui &amp; Hong Kong Sheng Kung Hui Foundation</i>	Profits on property redevelopment, change of intention, exemption under s.88	HCIA 2 & 3/2009 (2014) CACV 41/2010 (2016) FACV 16/2015

**Appendix 13**

**Page 306;  
308**

In Appendix 13 on page 306, add the case reference '[ (2016) FACV 16/2015 ]' to the case *Church Body of the Hong Kong Sheng Kung Hui*; and on page 308, replace the last paragraph with the following:

On appeal by the CIR, the CFA upheld the decision of the COA that there was no change of intention from capital investment to trading up to the period of time within which the taxpayers engaged in various activities to enhance the value of the land for realisation. However, the CFA held that there is no 'enhancement for realisation principle' as cited by the COA. Such principle is contrary to the holistic approach of taking into account all the facts and circumstances of a particular case in deciding whether the taxpayer is engaged in a trade, which is a question of fact and degree.

It was also found that the BOR, in its decision, failed to consider the critical 7<sup>th</sup> badge of trade, i.e. 'whether the taxpayer has expended time, money or effort in selling the asset or commodity that goes beyond what might be expected of a non-trader seeking to sell an asset of that class'. The BOR failed to consider whether the taxpayers had intended to sell merely as owners or as traders, and there was no evidence to support a finding of change of intention in September 1989 or December 1990.

In February 2016, the CFA held that the taxpayers' enhancement activities in 1989 or 1990 were necessary for finding out the potential of the land and ascertaining its maximum value. None of the activities had gone beyond what might be expected of a non-trade owner in similar circumstances. Accordingly, the CFA dismissed the CIR's appeal and remitted the case back to the BOR to determine if a change of intention occurred on a later date, as previously ordered by the COA.

## **Chapter 4 Non-resident persons**

**Section 2.8** Add the following at the end of Section 2.8 before Section 2.8.1 on page 376:

**Page 376**

The Inland Revenue (Amendment) (No. 2) Ordinance 2015 was enacted on 17 July 2015 to extend profits tax exemption to offshore private equity funds. DIPN 43 was revised and DIPN 51 was newly issued in May 2016 to reflect the IRD's latest practice accordingly.

**Section 2.8.1** Under Section 2.8.1 The exemption provisions on page 376, revise the following:

**Page 376**

(a) Replace paragraph (a) with the following:

Profits from dealing in 'specified transactions' carried out through or arranged by a 'specified person'; or the non-resident person is a qualifying fund (s.20AC(2));

(b) Delete the bracket 'excluding shares/debentures of a private company' from item (a) 'A transaction in securities' under 'Key terms' box.



- (c) Replace the paragraph 'Appendix C of DIPN 43 (Revised) sets out the IRD's view on whether particular transactions are covered by the specified transactions' with the following under 'Key terms' box:

Appendix B of DIPN 43 (Revised) sets out the IRD's view on whether particular transactions are covered by the specified transactions. The IRD is of the view that the holding of debentures, loan stocks, bonds or notes to earn 'interest income' is not a transaction in securities since such holding does not involve two transacting parties and cannot be regarded as a transaction. The interest derived therefrom could only be considered as derived from incidental transactions and not specified transactions (DIPN 43 (Revised), para 24).

**Section 2.8.1** Replace paragraph (a) under the heading Conditions for exemption on page 377  
**Page 377** with the following:

- (a) The non-resident person must not carry on any trade, profession or business in Hong Kong involving any transactions other than those that attract the exemption (s.20AC(3)). Specifically, the person is not permitted to engage in the following activities (which are not exhaustive) in Hong Kong:
- (i) property development or property holding;
  - (ii) finance (banking, providing capital, leasing, factoring or securitisation);
  - (iii) insurance;
  - (iv) construction or acquisition of infrastructure facilities; or
  - (v) making investments that derive rent, royalties or lease payments.

**Section 2.8.1** Replace all the paragraphs under the heading Determining the central  
**Page 377** management and control on page 377 with the following:

The IRD clarifies its practice on determining the 'central management and control' in the revised DIPN 43 (2016). The IRD states that the location of 'central management and control' is wholly a question of fact. In general, if the 'central management and control' of a company is exercised by the directors in board meetings or by the partners in partners meetings, the relevant locality is where those meetings are held. The residence of individual directors or partners will not generally be a relevant factor to consider. The mere fact that the majority of the directors of a company or partners of a partnership are resident in Hong Kong does not of itself mean that the company or partnership is centrally managed and controlled in Hong Kong, and hence would not adversely affect application of the exemption. However, this does not mean that an individual director's or partner's residence can be completely ignored in all cases. Para 16 of the revised DIPN 43 states:

*The place of board meetings or partners meetings also is not necessarily conclusive ... In cases where central management and control of a company or a partnership is in fact exercised by an individual (for example, the board chairman, the managing director or general partner), the relevant locality is the place where the controlling individual exercises his power. As central management and control is a question of fact and reality, when reaching a conclusion in accordance with case law principles, only factors which exist for genuine commercial reasons will be accepted.*



In reality, the residence of individual directors or partners could be a relevant factor. For instance, where all or a majority of the individual directors or partners are Hong Kong residents and there are no genuine commercial reasons for holding board meetings or partners meetings overseas, the IRD may contend that such meetings are only a formality and that the 'central management and control' of the company or partnership is actually exercised by the directors or partners in Hong Kong through other means. Appendix A in DIPN 43 (Revised) sets out the IRD's views on the residency status of various forms of investment vehicles commonly adopted in holding and managing investment portfolios.

The above discussion is in the context of a corporation or a partnership. However, the IRD has indicated that a similar test would apply to determine the residence of a trust.

<b>Section 2.8.3</b> <b>Page 378</b>	Add the following paragraph after the last paragraph under Section 2.8.3 The deeming provisions (anti-avoidance provisions) on page 378:  The term 'associate' is widely defined in s.20AC(6).
<b>Section 2.8.3</b> <b>Page 379</b>	On page 379, at the end of line 17, revise '(DIPN 43 para 64)' to '(DIPN 43 (Revised) para 62)'; and at the end of line 20, revise 'para 65' to 'para 63'.
<b>Section 2.8.3</b> <b>Page 379</b>	Under the heading Determining the direct beneficial interest on page 379, (1) Add the following paragraphs before the first paragraph:  S.20AB(4) provides that a person is to be regarded as having a direct beneficial interest in a corporation, a partnership, a trustee of a trust estate or any other entity if:  (a) he holds any of the issued share capital of the corporation (where the corporation is not a trustee of a trust estate);  (b) he, as a partner in the partnership, is entitled to any of the profits of the partnership (where the partnership is not a trustee of a trust estate); or  (c) he, otherwise than through another person, (i) benefits under the trust estate; or (ii) not being a trustee of the trust estate (or a director of the trustee where the trustee is a corporation), 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;  (d) he has any of the ownership interests in the entity which is not a corporation, a partnership and a trustee of a trust estate.  (2) Revise 'para 49' to 'para 47' in line 3 of the last paragraph.
<b>Section 2.8.3</b> <b>Page 380</b>	Under the heading Determining the indirect beneficial interest on page 380, add the following paragraphs before the first paragraph:  S.20AB(5) provides that a person is to be regarded as having an indirect beneficial interest in a corporation, a partnership, a trustee of a trust estate or any other entity if, through an interposed person or a series of two or more interposed persons:  (a) he is interested in any of the issued share capital of the corporation (where the corporation is not a trustee of a trust estate);

- 
- (b) he is entitled to any of the profits of the partnership (where the partnership is not a trustee of a trust estate); or
  - (c) he
    - (i) benefits under the trust estate; or
    - (ii) not being a trustee of the trust estate (or a director of the trustee where the trustee is a corporation), 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;
  - (d) he has any of the ownership interests in the entity which is not a corporation, a partnership and a trustee of a trust estate.
- 

**Section 2.8.3** Under the heading No deemed loss for resident persons on page 382, revise  
**Page 382** 'para 61' to 'para 59' at the end of the paragraph.

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**Section 2.8.3** Under the heading Loss set off against deemed assessable profits by resident  
**Page 382** persons on page 382, revise 'para 62' to 'para 60' at the end of the paragraph.

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**New Section** Add a new Section 2.8.4 after Section 2.8.3 on page 383:  
**2.8.4**

**Page 383**

2.8.4 Exemption extended to offshore private equity funds

Before 1 April 2015, the definition of 'specified transactions' in Schedule 16 did not include securities of a private company. Therefore, the exemption for offshore funds did not apply to private equity funds that typically invest in private companies. The Inland Revenue (Amendment) (No. 2) Ordinance 2015 was enacted on 17 July 2015 to:

- (a) Extend the exemption to transactions in securities in 'excepted private companies' occurring on or after 1 April 2015;
- (b) Waive the requirement for transactions to be carried out through or arranged by persons licensed by the SFC; and
- (c) Extend the exemption to special purpose vehicles ('SPVs') which are established to hold offshore investments.

It is expected that more private equity fund managers will set up or expand their business in Hong Kong, which will be conducive to the future development of Hong Kong's asset management industry.

In May 2016, IRD issued DIPN 51 to set out its views on various issues relating to the application of the offshore private equity fund tax exemption regime.

Exemption for excepted private companies

An excepted private company is a private company incorporated outside Hong Kong which satisfies all of the following conditions at all times within the three years before a transaction in shares, stocks, debentures, loan stocks, funds, bonds or notes in the private company is carried out (s.20ACA(2)):

- (a) It did not carry on any business through or from a permanent establishment ('PE') in Hong Kong. However, the excepted private company is allowed to have some insignificant business activities in Hong Kong but the business activities must be of a purely preparatory or auxiliary character and the place of business does not constitute a PE (DIPN 51, para 20).
-

- (b) It falls within either of the following descriptions:
- (i) It did not hold (whether directly or indirectly) share capital in one or more private companies carrying on any business through or from a PE in Hong Kong;
  - (ii) It held such share capital, but the aggregate value of the holding of the capital is equivalent to not more than 10% of the value of its own assets.

The 'value of the holding of the capital' refers to the market value and not the par value or nominal value of the capital; and the 'value of the assets' refers to the gross amount (DIPN 51, para 23).

- (c) It falls within either of the following descriptions:
- (i) It neither held immovable property in Hong Kong, nor held (whether directly or indirectly) share capital in one or more private companies with direct or indirect holding of immovable property in Hong Kong;
  - (ii) It held such immovable property or share capital (or both), but the aggregate value of the holding of the property and capital was equivalent to not more than 10% of the value of its own assets.

**New Example 12**      **Example 12 (Adapted from DIPN 51, Example 5)**

On 1 January 2010, Limited Partnership F1 resident in Jurisdiction F1 acquired 40% of the share capital in Company F2 ('Co F2'). Co F2 was incorporated as a private company in Jurisdiction F2 and it closed its accounts on 31 December every year. At all relevant times, Co F2 held:

- (a) a property in Hong Kong;
- (b) 30% of the share capital in Company HK1 ('Co HK1') which was carrying on a trade in Hong Kong; and
- (c) 60% of the share capital in Company HK2 ('Co HK2').

Company HK3 ('Co HK3') and Company HK4 ('Co HK4'), each of which held a property in Hong Kong, were wholly owned by Co HK2.

On 1 January 2016, Limited Partnership F1 sold its shares in Co F2 and made a profit. The financial statements of Co F2 gave the following details:

<i>As at</i>	<i>Market value of total assets of Co F2</i>	<i>Market value of HK property held by Co F2</i>	<i>Market value of shares in Co HK1 held by Co F2</i>	<i>Market value of shares in Co HK2 held by Co F2</i>
31.12.2012	\$900m	\$80m	\$4m	\$8m
31.12.2013	\$1,000m	\$90m	\$5m	\$10m
31.12.2014	\$1,200m	\$98m	\$7m	\$12m
31.12.2015	\$1,250m	\$100m	\$8m	\$15m

Limited Partnership F1 could rely on the available financial statements to perform the below calculations:

As at	Aggregate value of property and shares as a percentage of the value of total assets of Co F2
31.12.2012	$(\$80m + \$4m + \$8m) / \$900m = 10.2\%$
31.12.2013	$(\$90m + \$5m + \$10m) / \$1,000m = 10.5\%$
31.12.2014	$(\$98m + \$7m + \$12m) / \$1,200m = 9.8\%$
31.12.2015	$(\$100m + \$8m + \$15m) / \$1,250m = 9.8\%$

The aggregate market value of the property in Hong Kong and the shares in Co HK1 and Co HK2 was not, at all times within the three years (i.e. from 1 January 2013 to 31 December 2015) before the sale of the shares in Co F2, equivalent to not more than 10% of the market value of the total assets of Co F2. Therefore, the profit derived by Limited Partnership F1 from the sale of the shares in Co F2 would not be exempt under s.20AC.

For the purpose of the calculation, the values of the holding of share capital in Co HK3 and Co HK4 (having immovable properties in Hong Kong), indirectly held by Co F2 via Co HK2, do not need to be taken into account.

For the meaning of 'private company' and 'PE', please refer to the below:

A **'private company'** means a company incorporated in or outside Hong Kong that is not allowed to issue any invitation to the public to subscribe for any shares or debentures of the company (s.20ACA(2)).

A **'PE'** is a fixed place of business through which activities of the company are carried on, including a branch and a place of management (s.20ACB(1)), which usually refers to a place of work or an office where some of the supervisory activities for a private company is exercised (DIPN 51, para 28). Under s.20ACB(2), a private company is regarded as having a PE in Hong Kong if the company has an agent carrying on activities in Hong Kong who:

- (a) Has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of the company; or
- (b) Has a stock of merchandise from which the agent regularly fills orders on behalf of the company.

However, under s.20ACB(3), in relation to the business of the company as a whole, the activities mentioned in ss.20ACB(1) and (2) exclude the following activities which are purely of a preparatory or auxiliary character:

- (a) The use of facilities solely for storage, display or delivery of goods or merchandise belonging to the company;
- (b) The maintenance of a stock of goods or merchandise belonging to the company solely for storage, display or delivery, or for processing by another business; and
- (c) The maintenance of a fixed place of business solely for purchasing goods or merchandise or for collecting information, for the company.

To qualify for the exemption, the offshore private equity fund must carry out the specified transactions through corporations licensed by the SFC or be a 'qualifying fund' (s.20AC(2)(b)). To be a 'qualifying fund', and hence eligible for tax exemption the following conditions must be met:

- (a) At all times after the final closing of sale of interests:
  - (i) The number of investors in the fund exceeds four (excluding the originator and its associates); and
  - (ii) The capital commitments made by the investors (excluding the originator and its associates) exceed 90% of the fund's aggregate capital commitments; and
- (b) The originator and its associates do not receive more than 30% of the net proceeds arising out of the transactions of the fund, after deducting the portion attributable to their capital contributions.

The 90% capital commitment condition and the 30% threshold of the net proceeds aim to ensure that the private equity fund is a bona fide private equity fund and is not simply a vehicle of one single investor.

For the meaning of 'investor', 'originator', 'capital commitment', 'aggregate capital commitment', 'net proceeds', 'final closing of sale of interests' and 'associate', please refer to the below:

**'Investor'** means a person, other than the originator or the originator's associates, who makes capital commitment to the fund.

**'Originator'** means a person who directly or indirectly originates or sponsors the fund; and has the power to make investment decisions on behalf of the fund.

In the context of a limited partnership structure, generally the 'investors' are the limited partners and the 'originator' is the general partner.

**'Capital commitment'** means a commitment that is in the form of an amount of money payable by an investor, the originator or the originator's associate to the fund under an agreement governing the operation of the fund; and in respect of which the originator may make capital calls from time to time according to the terms of the agreement.

**'Aggregate capital commitment'** is the total of the capital commitments made by the investors, the originator and the originator's associates.

**'Net proceeds'** means an amount calculated by:

- (a) adding together
  - (i) the sum of the cumulative distributions received by the investors, the originator and the originator's associates from the fund; and
  - (ii) the value at that time of all assets, if any, held by the fund; and
- (b) subtracting from the sum calculated under (a) the cumulative capital contributions of the investors, the originator and the originator's associates.

**'Final closing of sale of interests'** means the date on which the originator last accepts subscriptions from investors for making capital commitments.

**'Associate'** is widely defined in s.20AC(6).

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### Exemption for special purpose vehicles

Exemption is extended to the profits of a SPV derived from a transaction in securities in an interposed SPV or an eligible private company, i.e. gains from the disposal of an excepted private company or from the disposal of a SPV that owns an excepted private company (s.20ACA).

For this purpose, the SPV may be a corporation, partnership, trustee of a trust estate or any other entity incorporated, registered or appointed in or outside Hong Kong; and must be wholly or partly owned by a non-resident person (i.e. an offshore fund). Moreover, the SPV is not itself an excepted private company (s.20ACA(2)).

However, the SPV must be established solely for the purpose of holding (directly or indirectly) and administering one or more excepted private companies, and must not carry on any trade or business in Hong Kong. The SPV should not engage in an active business with trading transactions; and cannot derive service fees from the non-resident person for the provision of services. It is expected to only derive passive dividend income from one or more excepted private companies (DIPN 51, para 48). Hence, activities of the SPV are restricted to:

- (a) Reviewing financial statements of excepted private companies;
  - (b) Attending shareholders' meetings of excepted private companies;
  - (c) Opening bank accounts to collect dividends and investment disposal proceeds; and
  - (d) Appointing company secretary and auditor (DIPN 51, para 49).
- 

### **New Example 13**    **Example 13 (Adapted from DIPN 51, Example 9)**

**13**

Limited Partnership F1 was a non-resident private equity fund. It held 100% of the share capital in Company F2 ('Co F2') in Jurisdiction F2, through two wholly owned SPVs, Company SPV1 ('Co SPV1') and Company SPV2 ('Co SPV2'), which were both Hong Kong incorporated companies without any trade or business activities in Hong Kong other than the holding of the share capital in Co F2. Co SPV1 held Co SPV2, which in turn held Co F2. Co F2 did not carry on any business or hold any immovable property in Hong Kong. Co F2 did not have interests in any other private companies.

Co SPV1 was a SPV and Co SPV2 was an interposed SPV. They both fell within the definition of SPV. They were used by Limited Partnership F1 to hold its equity investment in Co F2. Applying the exemption provisions:

- (a) Limited Partnership F1 would be exempt from tax on profits derived from disposal of shares in Co SPV1, a SPV (s.20AC(1)).
  - (b) Co SPV1 would be exempt from payment of tax on profits derived from disposal of shares in Co SPV2, an interposed SPV (s.20ACA(1)).
  - (c) Co SPV2 would be exempt from payment of tax on profits derived from disposal of shares in Co F2, an excepted private company (s.20ACA(1)).
-

### Loss from exempt transactions

Losses sustained by a tax-exempt offshore private equity fund from specified transactions in a year of assessment are not available for set off against any of its assessable profits for any subsequent year of assessment (s.20AD(a)).

Likewise, losses sustained by a SPV from a transaction referred to in s.20ACA(1) in a year of assessment are not available for set off against any of its assessable profits for any subsequent year of assessment (s.20AD(b)).

### The deeming provisions (anti-avoidance provisions)

Ss. 20AE and 20AF are anti-avoidance provisions to prevent round-tripping (i.e. resident persons taking advantage of the exemption by investing through non-resident entities). S.20AF also prevents booking of profits in SPVs without distributing to the fund.

Under s.20AE, when a resident person, either alone or jointly with his associates, holds a beneficial interest of 30% or more in a tax-exempt offshore private equity fund, or any percentage of the fund is the resident person's associate, the resident person is deemed to have derived assessable profits in respect of the profits earned by the fund from the specified transactions and incidental transactions carried out in Hong Kong. For details, refer to the discussions under Section 2.8.3 above.

Under ss.20AF(1) and (2), when a resident person:

- (a) alone or jointly with his associates, holds direct and/or indirect beneficial interest of 30% or more in a tax-exempt offshore private equity fund; or
- (b) holds any percentage in a tax-exempt offshore private equity fund if the fund is an associate of the resident person and the fund has a beneficial interest in a SPV which is exempt from tax under s.20ACA,

the resident person's share of the exempted profits of the SPV are to be regarded as the assessable profits of the resident person, regardless of whether the resident person has received, or will receive, directly or indirectly, any profit distribution from the SPV (s.20AF(3)). The resident person is also required to report the deemed assessable profits to the IRD.

The amount of deemed profits is ascertained by reference to the percentage of the resident person's beneficial interest in the SPV and the length of ownership within the relevant year of assessment.

However, the deeming provisions will not apply to a resident person, regardless of his percentage of ownership in a non-resident person, if the CIR is satisfied that the beneficial interests in the non-resident person are bona fide widely held (s.20AF(7)).

The term 'bona fide widely held' is not defined in the IRO. The 'bona fide widely held' requirement is satisfied if, at no time during the year of assessment in question:

- (a) Fewer than 50 persons hold (or have the right to become the holders of) all of the units or shares in the offshore fund; and
- (b) Fewer than 21 persons hold (or have the right to become the holders of) units or shares that entitle the holders, directly or indirectly, to 75% or more of the income or property of the offshore fund (DIPN 51, para 68).



If the above benchmark figures are not met, the requirement will still be satisfied if the fund is established with a view to wide public participation and there is nothing to suggest that the offshore fund is intended to be a closely held investment vehicle (DIPN 51, para 69).

#### Ascertaining the deemed assessable profits

The amount regarded as the assessable profits of a resident person for a year of assessment is ascertained in accordance with Schedule 15A by adding up the assessable profits of the SPV which are tax exempt for each day in the period in that year of assessment during which the resident person has an indirect beneficial interest in the SPV.

The exempt profits of the SPV for a particular day in a year of assessment (which is the deemed assessable profits of the resident person) are calculated using the following formula set out in Schedule 15A.

$$A = \frac{B1 \times B2 \times C}{D}$$

where:

- A means the exempt profits of the SPV for a particular day in a year of assessment;
- B1 means the extent of the resident person's beneficial interest in the non-resident person on the particular day, expressed as a percentage determined in accordance with Part 2 of Schedule 15;
- B2 means the extent of the non-resident person's beneficial interest in the SPV on the particular day, expressed as a percentage determined in accordance with Part 2 of Schedule 15A;
- C means the exempt profits of the SPV for the accounting period of the SPV in which the particular day falls;
- D means the total number of days in the accounting period of the SPV in which the particular day falls.

#### Determining the direct beneficial interest

In Schedule 15A, the extent of a non-resident person's direct beneficial interest in a SPV is determined as follows:

- (a) The percentage of the issued share capital of the corporation held by the non-resident person (where the SPV is a corporation);
- (b) The percentage of the profits of the partnership to which the non-resident person is entitled (where the SPV is a partnership);
- (c) The percentage in value of the trust estate in which the non-resident person is interested (where the SPV is a trustee of a trust estate); or
- (d) If the SPV is an entity that does not fall within any of paragraphs (a), (b) and (c), the percentage of ownership interests that the non-resident person has in the entity.



### Determining the indirect beneficial interest

In Schedule 15A, the extent of a non-resident person's indirect beneficial interest in a SPV is determined as follows:

- (a) Where there is one interposed person, by multiplying the percentage of the non-resident person's beneficial interest in the interposed person by the percentage of the interposed person's beneficial interest in the SPV; or
- (b) Where there are a series of two or more interposed persons, by multiplying the percentage of the non-resident person's beneficial interest in the first interposed person by the percentage of the first interposed person's beneficial interest in the next interposed person and so on; and finally by the percentage of the last interposed person's beneficial interest in the SPV.

#### **New Example 14**    **Example 14 (Adapted from DIPN 51, Example 10)**

Company HK ('Co HK'), a company resident in Hong Kong, purchased 20% of the equity interest in Fund F1 on 1 October 2014, and a further 30% equity interest on 1 January 2016. Fund F1 is a tax-exempt offshore fund and it is not Co HK's associate. Co HK and its associates have no other beneficial interest in Fund F1.

Co SPV is a SPV wholly owned by Fund F1. Co SPV is used to hold Co F2 which is an excepted private company in Jurisdiction F2.

Fund F1 closes its accounts on 31 March every year. During the year ended 31 March 2016, Fund F1 derived assessable profits of \$80m, excluding distribution from Co SPV, and Co SPV derived assessable profits of \$100m from disposal of shares in Co F2. Co SPV is exempt from payment of tax for the year of assessment 2015/16.

The deemed assessable profits of Co HK for the year of assessment 2015/16 is computed as follows:

$$\$80\text{m} \times 50\% \times \frac{91 \text{ days}}{366 \text{ days}} + \$100\text{m} \times 50\% \times 100\% \times \frac{91 \text{ days}}{366 \text{ days}} = \$22.4\text{m}$$

'91 days' refer to the period from 1 January 2016 to 31 March 2016, during which Co HK held a beneficial interest of 50% in Fund F1. The period from 1 April 2015 (date of commencement of the 2015 Ordinance) to 31 December 2015 need not be taken into account since Co HK only held a beneficial interest of 20% (i.e. less than 30%).

However, s.20AF(8) provides that a resident person is not liable to tax in respect of the deemed assessable profits if any of the interposed resident person, through whom he holds an indirect beneficial interest in a SPV, is liable to tax under the deeming provisions in respect of the assessable profits of the same SPV.

<b>New Example 15</b>	<b>Example 15 (Adapted from DIPN 51, Example 11)</b>
	<p>Company HK1 ('Co HK1') held 90% of the share capital of Company HK2 ('Co HK2') which in turn held 70% of the share capital of Company HK3 ('Co HK3'). Co HK3 held 50% of the equity interest in Fund F, a tax-exempt offshore private equity fund, which in turn held an excepted private company through a wholly owned SPV, Co SPV. Co HK1, Co HK2 and Co HK3 were all resident companies.</p> <p>Under ss.20AE(1) and 20AF(1), deemed assessable profits representing 50% of the exempt profits of Fund F (if any) and 50% of the exempt profits of Co SPV (if any) would be attributed to Co HK3.</p> <p>Under ss.20AE(9) and 20AF(8), no deemed assessable profits would be attributed to Co HK1 and Co HK2 notwithstanding that they both held indirect beneficial interests of more than 30% (Co HK1 = 90% × 70% × 50% = 31.5%; Co HK2 = 70% × 50% = 35%) in Fund F. Deemed assessable profits in respect of the same exempt profits of Fund F and Co SPV had already been imposed on Co HK3.</p>
<b>Original Section 2.8.4</b>	Renummer the original Section 2.8.4 Reporting requirements on page 383 as Section 2.8.5; and
<b>Page 383</b>	<p>(a) Add 'and s.20AF' after 's.20AE' in line 3;</p> <p>(b) Revise '(DIPN 43 (Revised), para 67)' in line 5 to '(DIPN 43 (Revised), para 65 and DIPN 51, para 71)';</p> <p>(c) Add 'and DIPN 51' after 'DIPN 43 (Revised)' in the second last line.</p>
<b>Section 3 Page 383</b>	<p>Under Section 3 Avoidance of double taxation on page 383, replace the sentence after 'Topic highlights' with 'As of 1 June 2016, Hong Kong has signed 35 comprehensive double taxation agreements and arrangements ('DTAs'); and replace the third paragraph with the following:</p> <p>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 2016, Hong Kong has concluded comprehensive DTAs with 35 jurisdictions including Austria, Belgium, Brunei, Canada, the Czech Republic, France, Guernsey, Hungary, Indonesia, Ireland, Italy, Japan, Jersey, Korea, Kuwait, Latvia, Liechtenstein, Luxembourg, the mainland of China, Malaysia, Malta, Mexico, the Netherlands, New Zealand, Portugal, Qatar, Romania, Russia, South Africa, Spain, Switzerland, Thailand, the United Arab Emirates, the United Kingdom and Vietnam.</p>
<b>Topic recap Page 384</b>	Under 'Topic recap' on page 384, under the column 'Double Taxation Agreements ('DTAs')', replace '32 comprehensive' with '35 comprehensive'.
<b>Further reading Page 386</b>	Add DIPN 51 Profits Tax Exemption for Offshore Private Equity Funds at the end of the list of primary references.

**Chapter 5 Hong Kong salaries tax**

**Section 5.7** Replace the second paragraph of Section 5.7 Elderly residential care expenses on page 417 by the following:

**Page 417**

Years of assessment	Deduction ceiling for elderly residential care expenses as specified in Schedule 3C of the IRO (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
Starting from 2016/17	\$92,000 (enacted on 27 May 2016)

The person claiming for the deduction of elderly residential care expenses should not be entitled to a dependent parent/grandparent allowance in respect of the same parent or grandparent. In addition, the salaries tax deduction is only allowable to one person in respect of each parent or grandparent of the person.

**Table** Modify the table for personal allowances on page 422 as described below:

**Page 422**

Under 2016/17 Budget, all personal allowances remain unchanged with the exception of basic allowance, married person's allowance, dependent parent/grandparent allowances and single parent allowance. The proposed changes (enacted on 27 May 2016) are as follows:

	2015/16 \$	2016/17 \$
Basic allowance	120,000	132,000
Married person's allowance	240,000	264,000
Dependent parent/grandparent allowance – for parent aged 60 or more* (each)	40,000	46,000
Dependent parent/grandparent allowance – for parent aged between 55 and 59 (each)	20,000	23,000
Additional dependent parent/grandparent allowance – for parent aged 60 or more* (each)	40,000	46,000
Additional dependent parent/grandparent allowance – for parent aged between 55 and 59 (each)	20,000	23,000
Single parent allowance	120,000	132,000

Proposed changes from the 2016/17 Budget were enacted on 27 May 2016. Deleted the note below to the table for personal allowances on page 422.

(&) Proposed changes from the 2015–16 Budget have not been enacted and subject to the passage by the Legislative Council.

**Table** Modify the following in the partial tax relief table for salaries tax and personal assessment on page 428:

**Page 428**

	2014/15	2015/16*
% of final tax reduction	75%	75%
Maximum limit	20,000	20,000

\* Proposed in 2016/17 Budget and enacted on 27 May 2016.

**Examples 6 and 7** Modify the notes in the Examples 6 and 7 on pages 431 and 432 respectively:

**Pages 431 and 432** **Note:** 75% tax reduction (capped at \$20,000) for 2014/15 proposed in 2015/16 Budget has been enacted.

### **Chapter 6 Hong Kong property tax**

No update for Chapter 6

### **Chapter 7 Personal assessment**

**Example 2** Modify the note in the Example 2 on page 487 as below:

**Page 487** **Note:** 75% tax reduction (capped at \$20,000) for 2014/15 proposed in 2015/16 Budget has been enacted.

**Answer** Modify the first sentence of Answer 1 on page 490 as below:

**Page 490** **Note:** 75% tax reduction (capped at \$20,000) for 2014/15 proposed in 2015/16 Budget has been enacted.

**Answer** Modify the first sentence of Answer 2 on page 493 as below:

**Page 493** **Note:** 75% tax reduction (capped at \$20,000) for 2014/15 proposed in 2015/16 Budget has been enacted.

### **Chapter 8 Hong Kong stamp duty**

**Section 4.4** Add a new Section 4.5 after Section 4.4 and self-test question 1 on page 532:

**Page 532** 4.5 Stamp duty waiver for transfer of shares or units of all Exchange Traded Funds

To promote the development, management and trading of Exchange Traded Funds ('ETFs') in Hong Kong, the Government proposed in the 2014–15 Budget to waive the stamp duty for the transfer of shares or units of all ETFs. Following the enactment of the Stamp Duty (Amendment) Ordinance 2015, any contract notes and instruments of transfer for the transactions of shares or units of all ETFs effected on or after 13 February 2015 are no longer required to be stamped or endorsed under the SDO.

### **Chapter 9 Introduction to tax planning**

No update for Chapter 9

### **Chapter 10 Tax investigation and field audit**

No update for Chapter 10

## Chapter 11 Tax compliance and tax advisory services

**Section 1** Add the following paragraphs after the flowchart (Objection and Appeal Process) of Section 1 on page 697:

**Page 697**

The Inland Revenue (Amendment) (No. 3) Ordinance 2015 was gazetted on 13 November 2015. The objectives are to enhance the tax appeal mechanism and improve the efficiency and effectiveness of the Board of Review.

The Inland Revenue (Amendment) (No. 3) Ordinance 2015 covers the following four aspects:

- (a) Allow an appeal against the decision of the Board of Review on a question of law to go direct to the Court of First Instance or, if applicable, the Court of Appeal. This abolishes the present case stated procedure under the Board of Review, which is not only time-consuming and costly, but also affects the capacity of the Board of Review to hear other appeals;
- (b) Empower the person presiding at the hearing of an appeal before the Board of Review to give directions on the provision of documents and information for the hearing. This is to address the situation of late submissions from time to time, which has affected the proceedings of the Board of Review and may also lead to rescheduling of hearings;
- (c) Provide privileges and immunities to the Chairman, Deputy Chairmen and other members of the Board of Review, and the parties to a hearing as well as other persons appearing before the Board of Review. This is in line with the arrangement of other statutory appeal boards; and
- (d) Raise the ceiling of costs to be paid by the appellant as may be ordered by the Board of Review from \$5,000 to \$25,000, to strengthen the deterrent effect against frivolous appeals. The current ceiling has not been adjusted since 1993.

**Example 8** Replace the address of Board of Review in the notice of appeal on page 725 by the following:

**Page 725**

Room 2020, 20/F, High Block  
Queensway Government Offices  
66 Queensway, Hong Kong

## Chapter 12 Double taxation arrangement and agreements

**Section 1.1** Replace the last paragraph of Section 1.1 on page 742 by the following:

**Page 742**

As of 1 June 2016, Hong Kong has signed 35 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 and Latvia.

**Section 3.1.1** Add the following paragraphs at the end of Section 3.1.1 on page 745:

**Page 745**

On 27 August 2015, the SAT issued *Public Notice [2015] No. 60* entitled 'Administrative Measures on Non-resident Taxpayers claiming Tax Treaty Benefits'. It sets out a new set of procedures for claiming benefits under tax treaties signed by China. It has become effective since 1 November 2015.

Under the *Public Notice*, all Hong Kong tax residents need to apply for Hong Kong Tax Resident Certificates and perform self-assessments if they would like to enjoy the tax treaty benefits under the China-HK DTA. Hong Kong tax residents should get prepared for the challenges under the new procedures.

**Section 3.1.6** Replace the last paragraph of Section 3.1.6 on page 749 by the following:

**Page 749** The Fourth Protocol has become effective since 29 December 2015.

**Section 4.3.2** Add the following at the end of the fifth paragraph of Section 4.3.2 on page 760:

**Page 760** The exchange of notes between Hong Kong and Japan entered into force from 6 July 2015.

Add the following after the sixth paragraph of Section 4.3.2 on page 760:

A summary of the TIEAs that have recently been put into force is provided as follows:

Country	Date of signature of TIEA	Gazetted	Came into force	Take effect
Denmark	22 Aug 2014	2 Oct 2015	4 Dec 2015	Y/A 2016/17
Faroese	22 Aug 2014	2 Oct 2015	4 Dec 2015	Y/A 2016/17
Greenland	22 Aug 2014	2 Oct 2015	17 Feb 2016	Y/A 2016/17
Iceland	22 Aug 2014	2 Oct 2015	4 Dec 2015	Y/A 2016/17
Norway	22 Aug 2014	2 Oct 2015	4 Dec 2015	Y/A 2016/17
Sweden	22 Aug 2014	2 Oct 2015	16 Jan 2016	Y/A 2016/17
USA	25 Mar 2014	25 Apr 2014	20 Jun 2014	20 Jun 2014

**Section 4.3.3** Add the following at the end of Section 4.3.3 on page 761:

**Page 761** The Inland Revenue (Amendment) Bill 2016 (the 'Bill') was gazetted on 8 January 2016. The Bill seeks to put in place a legal framework to implement the new international standard for automatic exchange of financial account information in tax matters ('AEOI') as promulgated by the OECD.

Under the AEOI standard, a financial institution ('FI') is required to identify financial accounts held by tax residents of jurisdictions with which Hong Kong has entered into an AEOI arrangement. FIs are required to collect the reportable information of these financial accounts, and furnish such information to the IRD. The IRD will exchange it with the tax authorities of AEOI partner jurisdictions on an annual basis.

The Bill covers the following four key areas:

(a) Scope of FIs and financial accounts to be reported

Based on the AEOI standard, the Bill sets out the definitions with adaptations where necessary by including references to Hong Kong's domestic law.

The Bill provides for certain FIs and accounts (known as 'non-reporting FIs' and 'excluded accounts' respectively), which present a low risk of being used for tax evasion, to be exempted from reporting.

(b) Obligations on FIs to identify reportable accounts and collect information from account holders

The Bill prescribes the due diligence procedures for FIs to identify whether a financial account is a 'reportable account'.

FIs must maintain and apply such procedures to identify accounts and collect information of account holders who are tax residents of the specific reportable jurisdictions.

To provide flexibility for FIs in carrying out the due diligence obligations, the Bill also provides that FIs may apply the same procedures to identify accounts and collect information of account holders who are tax residents of any other jurisdiction outside Hong Kong.

(c) Scope of information to be furnished by FIs to the IRD

The information to be exchanged includes name, address, jurisdiction of residence, taxpayer identification number, and the date and place of birth.

For financial account data, the information includes the account number, the year-end account balance or value, and the gross amount of interest, dividends and sale proceeds of financial assets.

(d) Enforcement powers for the IRD and sanctions against non-compliance

The Bill provides the IRD with necessary enforcement powers and proposes various penalty provisions for FIs, service providers and account holders.

**Section 5**

Replace the second paragraph in Section 5 on page 763 with the following:

**Page 763**

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 2016, Hong Kong has concluded comprehensive double taxation agreements with 35 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 and Latvia.

**Table**

Modify the table in Section 5 on pages 763 and 764 as follows:

**Pages 763 and 764**

Country	CDTA/ Protocol	Gazetted	Came into force	Take effect
Italy	CDTA	4 Oct 2013	10 Aug 2015	Y/A 2016/17
South Africa	CDTA	15 May 2015	20 Oct 2015	Y/A 2016/17
UAE	CDTA	15 May 2015	10 Dec 2015	Y/A 2016/17
Mainland of China	4 <sup>th</sup> Protocol	2 Oct 2015	29 Dec 2015	29 Dec 2015
Romania	CDTA	13 May 2016	Pending	Pending
Russia	CDTA	13 May 2016	29 Jul 2016	Y/A 2017/18
Latvia	CDTA	Pending	Pending	Pending



**Appendix 1****Page 774**

Add the following in Appendix 1 'Summary of avoidance of double taxation agreements' on page 774:

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
Romania	3%/5% <sup>(xvi)</sup>	0%/3%	3%	Exempted	Exempted	Both	Home country
Russia	5%/10% <sup>(xvi)</sup>	0%	3%	Exempted	Exempted	Both, except quoted shares, reorganisation and property dealing business	Home country
Latvia	0%/10% <sup>(xvi)</sup>	0%/10% <sup>(xvi)</sup>	0%/3% <sup>(xvi)</sup>	Exempted	Exempted	Both, except quoted shares and reorganisation	Home country

## Chapter 13 Overview of China tax system

**Section 5****Page 790**

Replace the two paragraphs under 'Topic highlights' in Section 5 on page 790 by the following:

In the past, Business tax ('BT') is a type of turnover tax imposed on the provision of taxable services, the assignment of intangible assets and the sales of immovable properties within China. If a service fell within the above scope of 'taxable services', it would be subject to BT instead of Value Added Tax ('VAT') (refer to Section 8 for details).

However, currently China's BT and VAT systems are in the state of transition, with a VAT reform programme applying to various services on a nationwide basis. Some services such as transportation services, modern services and telecommunication services have been subject to VAT instead of BT.

With effect from 1 May 2016, the VAT reform programme has expanded to cover sales of immovable properties, leasing of immovable properties and transfer of land use right, as well as provision of construction services, financial services and consumer services (see Section 14 and updates below for details).

As BT and VAT systems currently are in the state of transition, for completeness, the original BT regime (before the launch of the VAT reform programme) is still discussed below.

**Section 5.1****Page 791**

Replace the last paragraph of Section 5.1 on page 791 with the following:

China is now undergoing a VAT reform programme. Some services such as transportation services, modern services and telecommunication services have been subject to VAT instead of BT.

With effect from 1 May 2016, VAT reform programme has expanded to cover sales of immovable properties, leasing of immovable properties and transfer of land use right, as well as provision of construction services, financial services and consumer services (see Section 14 and updates below for details).



**Section 14.1** Add the following paragraphs after the last paragraph of Section 14.1 on page 807:  
**Page 807**

Expansion of VAT reform programme

On 24 March 2016, the Ministry of Finance and the SAT jointly released *Caishui [2016] No. 36* setting out the expansion measures of the VAT reform programme.

*Caishui [2016] No. 36* became effective from 1 May 2016. VAT reform programme has expanded to cover the following industries or activities at the applicable rates:

- Construction services – 11%;
- Sales of immovable properties, leasing of immovable properties and transfer of land use right – 11%;
- Leasing of tangible movable properties – 17%;
- Financial services – 6%;
- Consumer services – 6%. 'Consumer services' are services and activities aiming at meeting residents' daily-life needs, and include cultural and sports services, entertainment services, tourism services, education services, medical services, catering services, accommodation and other relevant services.

*Caishui [2013] No. 106* has been abolished after *Caishui [2016] No. 36* became effective.

Some of the salient points of *Caishui [2016] No. 36* are as follows:

Calculation of VAT liabilities

The PRC tax authorities have the right to determine the sales amount of taxable activities provided by a taxpayer if the consideration is obviously low or high and without reasonable commercial purpose.

If an enterprise provides VAT-able activities that are subject to different VAT rates, the enterprise should separately account for the turnover for each activity. If the activities cannot be separately accounted for, the highest VAT rate would be adopted.

Construction industry

For construction industry, in order to avoid the increase of tax burden (VAT rate is now 11%) at the initial stage, there is a transitional policy for those construction projects that commenced on or before 30 April 2016. A general VAT payer may select the simplified VAT method under which the 3% rate is adopted for calculating its VAT liability provided that it only provides labour construction services and auxiliary materials, or provides construction services under which the principal is responsible for providing equipment and materials.

Real estate industry

VAT incurred for the purchase of immovable property is creditable provided valid VAT invoices are obtained. The input VAT can be credited over two years with 60% in the first year (i.e. the year of purchase) whilst the remaining 40% in the second year.

For real estate developers who are general VAT payers, the land cost paid to the government should be deducted from the total sales amount in calculating the taxable sales amount provided that valid invoices are obtained.

For the sales of residential properties by individuals, the VAT treatment depends on the length of ownership and the location of the residential properties. A summary of the VAT treatment is as follows:

Location	Residential properties are sold within two years	Residential properties are sold two years or more after purchase
Beijing, Shanghai, Guangzhou and Shenzhen	5% on the full consideration	<ul style="list-style-type: none"> <li>● Non-ordinary residential property – 5% on the balance of sales consideration less purchase cost subject to VAT</li> <li>● Ordinary residential property – exempt from VAT</li> </ul>
Other than the above four cities	5% on the full consideration	Exempt from VAT

Other transitional measures for real estate industry are as follows:

- If a general VAT payer sells an immovable property (excluding a self-developed property) acquired on or before 30 April 2016, the general VAT payer can elect to use the simplified VAT method to prepay VAT. Under the simplified VAT method, the applicable VAT rate of 5% is imposed on the balance of sales amount less the purchase cost.
- If a general VAT payer sells a self-developed property developed on or before 30 April 2016, the general VAT payer can elect to use the simplified VAT method to prepay VAT. Under the simplified VAT method, the applicable VAT rate of 5% is imposed on the full sales amount.
- If a general VAT payer leases an immovable property acquired on or before 30 April 2016, the general VAT payer can elect to use the simplified VAT method to prepay VAT at 5%.

#### Financial services

The VAT turnover for lending business is the total amount of interest income and income in the nature of interest derived from the provision of lending services.

Input VAT incurred on advisory fees, commission charges, etc. paid by a taxpayer in relation to lending services received by the taxpayer are not creditable.

For the trading of financial products such as marketable securities, foreign exchange and other financial products, the taxable VAT turnover is the balance of sales consideration less the purchase price.

#### Consumer services

Consumer services cover taxable services in non-production stages or for individual consumption purposes under the categories of 'service industries, entertainment services as well as cultural and sport services' in the original BT regime.

Input VAT on catering services, resident daily services or entertainment services is not creditable even if the taxpayers have obtained the valid invoices.

Taxpayers providing tourism services can elect the taxable turnover for VAT computation as the balance of 'total consideration and fees received from the customers' less 'charges for accommodation, meals, transportation and admission ticket fees and tour fees paid to other sub-contracted tourism enterprises' provided that valid invoices are obtained.

**Section 14.2**

Replace the whole Section 14.2 on pages 807 and 808 with the following:

**Pages 807  
and 808**

On 18 September 2013, the SAT issued *Public Notice [2013] No. 52* to set out the guidance for the implementation of VAT exemption for cross-border services under the VAT reform programme. *Public Notice No. 52* applied retroactively as from 1 August 2013.

On 27 August 2014, the SAT issued *Public Notice [2014] No. 49* to revise the VAT exemption implementation guidance under *Public Notice [2013] No. 52*. *Public Notice [2014] No. 49* became effectively from 1 October 2014. *Public Notice [2013] No. 52* has been abolished since then.

On 6 May 2016, the SAT issued *Public Notice [2016] No. 29* to provide more detailed guidance for the implementation of VAT exemption for cross-border activities under the VAT reform programme. *Public Notice [2014] No. 49* has then been abolished accordingly.

The cross-border activities eligible for VAT-exemption under *Public Notice [2016] No. 29* include, but not limited to, the following:

- Construction services provided that the construction project would be undertaken outside mainland China;
- Construction supervisory services provided that the construction project would be undertaken outside mainland China;
- Geotechnical investigations, surveying and exploration services for projects and mineral resources located outside mainland China;
- Conference and exhibition services provided that the conference and exhibition would be held outside mainland China;
- Warehousing services provided that the storage sites are located outside mainland China;
- The leasing of tangible and movable assets provided that the assets would be used outside mainland China;
- Broadcasting of TV and radio programs and films outside mainland China;
- Cultural and sports services, education and medical services and tourism services provided that the services are rendered outside mainland China.

