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

By email (fsie@fstb.gov.hk)

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Secretary for Financial Services and the Treasury
Financial Services and the Treasury Bureau (Treasury Branch)
24/F, Central Government Offices
2 Tim Mei Avenue, Tamar
Hong Kong

(Attn: Mr Stephen Lo)

Dear Sir,

Consultation on proposal to refine Hong Kong's foreign source income exemption regime for passive income

Thank you for inviting the views of the Hong Kong Institute of Certified Public Accountants ("the Institute") on the proposals to refine Hong Kong's foreign source income exemption ("FSIE") regime ("refined regime") for passive income. The Institute's Taxation Faculty Executive Committee and its International Taxation Task Force have reviewed the proposals in the consultation paper ("CP"). While we appreciate the rationale for the proposed measures, which aim to address the concerns of the European Union ("EU") about the potential for double non-taxation in the existing FSIE regime, and support the government's efforts to deal with those concerns, we have some comments and suggestions to offer in relation to certain specific aspects of the proposals. Our general and more detailed comments are set out below for your consideration.

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1. General comments on the proposals

Since October 2021, the EU has put Hong Kong on its so-called "grey list", i.e. its watch list of non-cooperative jurisdictions for tax purposes, because of the possible risks of double non-taxation arising from the tax exemption for offshore passive income, in the absence of any requirement for recipient companies to have a substantial "economic presence" in Hong Kong. We understand that, if Hong Kong does not adequately respond to the EU's concerns, it is likely to be blacklisted by the EU for tax purposes, and Hong Kong-based enterprises may be subject to defensive tax measures imposed by the EU Member States. This is clearly not desirable.

We are aware that, in order to ensure that Hong Kong is not included on the blacklist, the government has been working closely with the EU to understand and address the issues that they have raised about Hong Kong's offshore regime. The government announced in a public statement in October 2021 that Hong Kong's FSIE regime would be refined by the end of 2022 with a view to bringing the refined regime into force as from 1 January 2023, with no grandfathering arrangements. We appreciate that the government has had to engage in difficult negotiations in order to achieve the consensus reached with the EU's Code of Conduct Group (Business Taxation), in June 2022, on a package of proposed

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refinements to the FSIE regime. We also acknowledge the government's active participation in, and support of, international tax cooperation.

It is encouraging to note the government's commitment, in paragraph 6 of the CP, that under the proposed refined regime:

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

We also welcome the statement, in paragraph 9(c) of the CP, that "it is not our policy objective to generate fiscal revenue through the refined FSIE regime".

As the above background, our general comments are set out below for your consideration:

- We are aware that is has not been possible to negotiate "bright line" tests on matters such as the economic substance requirements ("ESRs"), which will be imposed on companies receiving certain kinds of offshore passive income, if they wish to continue to enjoy exemptions, or to apply these requirements on a group, as opposed to, an entity basis. However, we cannot over-emphasise the importance of certainty and predictability to businesses in terms of their tax treatment. In addition, the burden of compliance is another important factor in determining the relative competitiveness of Hong Kong over other possible locations for investment. If as a result of the implementation of the refined regime, individual businesses end up being highly uncertain for several years whether or not they will face a substantial tax liability, and possibly not until the outcome of a tax audit, under the Inland Revenue Department ("IRD")'s "assess first audit later" procedure, this could have very damaging impact on the overall investment environment in Hong Kong.

- Therefore, it will be important to provide sufficient flexibility, within the framework negotiated with the EU, to enable "covered" multinational enterprises ("MNEs") to seek greater certainty through means such as advance rulings ("ARs") and advance pricing agreements ("APAs") and, more generally, for the IRD to demonstrate a reasonable degree of flexibility, in terms of how the detailed conditions of ESRs, etc. are applied. Clear guidance and examples of what will be permissible, or not permissible as the case may be, should be provided in guidance, including departmental interpretation and practice notes ("DIPNs").

- Furthermore, the information that IRD will require MNEs to provide to enable the department to monitor and ensure compliance needs to be reasonable and not go beyond the bounds of what is strictly necessary or possible. Timelines should take account of the need to obtain information from third parties in some cases.

- There is some concern that "the devil is in the detail" and the details of how the refined regime will be implemented in practice, particularly if it is to be implemented through amendments to the Inland Revenue Ordinance (Cap. 112) ("IRO"), will be crucial. As such, we would appreciate the opportunity to comment on any draft bill, in due course, even though we know that timelines are likely to be tight, given the implementation date of 1 January 2023 for the refined regime.

- Although the source of profits and ESRs will be considered in separate contexts, taxpayers will have broad concerns that: (i) offshore claims generally may be affected/ tainted if the relevant activities are carried out in Hong Kong; (ii) the argument for offshore disposal gains being capital in nature may no longer be available; and (iii) offshore royalty income for marketing-related intellectual property ("IP"), e.g., trademarks and copyright, will not be eligible for exemption under the refined regime.

  We would urge the government take the above concerns fully on board and provide further clarification and clear guidelines as to how such business arrangements will be handled in future.

- Other areas that will require clarification include the interactions between various existing provisions of the IRO and the refined regime, such as the impact that the refined regime have, if any, on the various preferential tax regimes that have been introduced in Hong Kong in recent years. For example, if a taxpayer is eligible for the unified fund exemption, but it cannot meet the ESRs under the refined regime, will the taxpayer still be able to enjoy the profits tax exemption under the unified fund exemption regime?

- In recent years, a number of tax regimes and/or concessions have been introduced in Hong Kong and others are in the pipeline, including the unified fund exemption regime, tax concessions for certain shipping-related activities and the proposed family office tax exemption regime. These tax regimes have emphasised the importance of economic substance in Hong Kong as a condition for obtaining the tax benefits. While this is reasonable, and in line with the latest international tax standards, nevertheless, it can present practical challenges to taxpayers, for example issues regarding outsourcing of functions to related parties, or regulatory and licensing requirements around the setting up of entities/ businesses.

  While we understand that IRD will consider matters on a case-by-case basis, and the need to retain some flexibility is appreciated, the case-by-case approach is not conducive to promoting consistency and certainty. Therefore, further information and guidance will greatly benefit the business community in this important and evolving area. This could include strawman guidance on permitted activities and, where possible, potential safe harbours, and case studies of non-permissible structures or fact patterns (e.g., negative lists). Such guidance could explore the ESRs more broadly in various tax regimes and concessions in Hong Kong. We believe that this would help taxpayers to meet their tax obligations, while balancing the practical operational challenges in applying for the tax exemptions.

- With the refinements of the FSIE regime, various concepts which are new to the Hong Kong tax system, such as the “nexus” approach for IP income, “participation exemption”, “switch-over” rule, “anti-hybrid mismatch” rule, and unilateral tax credits, will come into play. These represent significant new developments and Hong Kong’s territorial source principle of taxation will no longer be as straightforward as it has been previously. MNE groups will need considerable time to understand the details, review their existing investment holding structures and operating models and consider making adjustments, in order to assess whether and how they can preserve their existing tax exemptions. Therefore, we recommend that the government should promote the refined regime by conducting briefing webinars and issuing detailed guidelines at an early stage. Meanwhile, suitable transitional arrangements should be considered and sufficient time allowed for taxpayers to prepare themselves before the refined regime comes into force in 2023. During, say, the first one or two years, the IRD should consider adopting a more flexible approach in relation to some of the administrative requirements.

- We understand that the refined regime offshore passive income, as outlined in the CP, is the outcome of a consensus reached between the government and the EU’s Code of Conduct Group (Business Taxation) and, this being the case, the CP seeks comments from stakeholders primarily on the implementation and administrative arrangements, rather than the major features of the refined regime or broader policy considerations. The refined regime represents a significant change to the long-established offshore regime in Hong Kong, specifically for MNE groups, and the technical details may not be open to further negotiations with the EU, even though stakeholders may have reasonable concerns about the arrangements and their potential impact on the investment environment, as noted above. This highlights the importance of involving stakeholders as early as possible in any future negotiations with international parties. In this way, the government can be better informed about the critical issues from taxpayers’ and practitioners’ perspective, which should, in principle, provide a solid base from which to negotiate.

- Against the background of a rapidly evolving international tax environment, which could make it more complicated to rely on tax incentives and a low tax regime alone to attract future investment, we would suggest that there is a need to review Hong Kong’s investment promotion strategies and policies. Consideration needs to be given to Hong Kong’s positioning and to possible non-tax incentives and advantages that can be offered to boost Hong Kong’s standing and reputation as an attractive location for investment. It is important to maintain an open dialogue with a diverse range of stakeholders to generate fresh, new and innovative ideas. In the Institute’s budget submission to the financial secretary, we also suggested that a major conference/ symposium and/or a series of forums/ focus group discussions be held on this theme. We are aware that some events of this kind are already being organised, but the continuing anti-Covid measures limit what can be done in terms of physical events involving overseas parties at this stage. Other means should therefore be explored to tap into the views of stakeholders, particularly non-local stakeholders.

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2. *Comments on the specific proposals in the CP*

Covered income and covered taxpayers (paragraphs 10 to 15 of the CP)

Under the refined regime, offshore passive income will be deemed to be sourced from Hong Kong and chargeable to profits tax if: (a) the income is received in Hong Kong by a constituent entity of an MNE group, irrespective of its revenue or asset size; and (b) the recipient entity fails to meet the ESRs (for non-IP income), or fails to comply with the nexus approach (for in-scope IP income).

We note that the definitions of "MNE group" and other related terms follow those of the Global Anti-Base Erosion ("GloBE") Rules promulgated by the Organisation for Economic Co-operation and Development ("OECD"). Under the GloBE rules, a "constituent entity" does not include an entity that is an excluded entity (e.g. an investment fund that is an ultimate parent entity of an MNE group). Clarification is needed as to whether a similar exclusion will be available under the refined regime.

The definition of the term "received in Hong Kong", which will affect significantly the scope of covered income, is not clear. It is not limited to income remitted into Hong Kong or the physical transfer of the monies to a Hong Kong bank account. It may also cover the situations where the offshore passive income in question is used to settle or offset an inter-company debt payable by a Hong Kong group company and to fund re-investments overseas. From a practical point of view, how this term is defined could determine issues such as whether, and for how long, a covered taxpayer will be able to defer the taxation of in-scope income under the refined regime.

We understand that the EU generally agrees to the approach of adopting the definition of "received in" as found in the Singapore Income Tax Act [Section 10(25)], which states:

(25) It is hereby declared for the avoidance of doubt that the amounts described in the following paragraphs shall be income received in Singapore from outside Singapore whether or not the source from which the income is derived has ceased:

(a) any amount from any income derived from outside Singapore which is remitted to, transmitted or brought into, Singapore;
(b) any amount from any income derived from outside Singapore which is applied in or towards satisfaction of any debt incurred in respect of a trade or business carried on in Singapore; and
(c) any amount from any income derived from outside Singapore which is applied to purchase any movable property which is brought into Singapore.

If Hong Kong adopts a similar definition, further clarification on the following issues will be needed:

- Definition of "*any debt incurred in respect of a trade or business carried on in Hong Kong*" – For example, if a dividend is directly used to repay a non-trade loan from an overseas shareholder, would this also be regarded as being "received"?

- A Hong Kong company's dividend payable to its shareholders after it has been declared may represent a business debt. This begs the question of whether applying dividend income from a company's subsidiaries, received in an offshore bank account, for payment of dividends to its shareholders, would be considered as being "applied in or towards satisfaction of any debt incurred in respect of a trade or business carried on in Hong Kong"?

- In Singapore, dividends are taxable, but the timing of taxation is upon remittance or when the money is considered to be "received". The Inland Revenue Authority of Singapore adopts a "tracking" approach to track when and how dividends are eventually received and used. Will Hong Kong adopt a similar approach? If yes, if a dividend is declared in Year 1 (i.e., recorded as income in the recipient's books) and the money is received in Year 3, will the IRD look at the economic substance of the taxpayer in Year 1 or Year 3?

To maintain Hong Kong's competitiveness as an international business centre, any deemed constructive receipt of offshore passive income in Hong Kong included in the definition of the term "received in Hong Kong", should not be wider than as defined in the Singapore law referred to above.

While there will be no grandfathering arrangements, we understand that the refined regime will not cover passive income that has been accrued, but not yet received before 1 January 2023. If this is correct, it should be stated explicitly in the legislation and/ or guidance.

Usually, financial statements are prepared on an accrual basis and the tax treatment generally follows the accounting treatment. It seems that the requirement that the passive income has to be "received" before it is deemed as Hong Kong-sourced income departs from the above principle and certain tax adjustments may have to be made in tax computations accordingly.

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In light of the above, guidance will be needed as to how the term "received in Hong Kong" will be defined and applied. The government should also consider issuing some practical examples on how tax practitioners should deal with the potential adjustments in tax computations.

Group versus entity basis for substance requirement

We understand that under the agreement with the EU, the ESRs must be considered on case-by-case and single entity basis, and that the IRD will have regard to the totality facts in each case. This could create difficulties for MNE groups, which may, for example, engage staff through one entity and carry out other activities, such as investing, through other group entities. While, as indicated in paragraph 12(c) of the CP, outsourcing to related entities will be permitted, it will be important, particularly for groups of companies that are clearly Hong Kong groups or have strong base in Hong Kong, that the government adopts a flexible approach in terms of the permitted outsourcing arrangement between entities within the group. To do otherwise would seem to go beyond the objective of the agreement with the EU.

It will also be essential that MNEs are able to achieve a reasonable level of certainty about their tax liabilities, which, in turn, means that they will need to know whether they have fulfilled their ESRs. The IRD should be prepared to issue ARs on this issue and to include ESRs as a collateral element of APAs, where appropriate. The outcome of these ARs and APAs should be able to be applied for several years of assessment, provided that there are no material changes in the circumstances of the relevant taxpayers. Such assurance should be made clear in writing, in the ARs/ APAs themselves as well as being provided for DIPNs/ guidance, to enhance certainty and confirm that a consistent approach will be adopted by the IRD over a period of years.

Monitoring of outsourced activities

Paragraph 12(c) of the CP also indicates that the taxpayer should be able to demonstrate adequate monitoring of outsourced activities. We understand that there is no strict definition internationally of what constitutes “adequate monitoring’ in this context. Similar terminology is used in the OECD’s base Erosion and Profit Shifting action plans, but it is also not defined. An MNE group will generally not set up its organisation in a way that would enable the activities of specific staff to be closely correlated with particular transactions, such as a dividend or capital disposal. This needs to be recognised and accommodated when IRD considers the adequacy of outsourced arrangements and the monitoring of these.

Capital versus revenue

The overriding of the capital versus revenue distinction in Hong Kong is a very major change for Hong Kong, even if it is confined to the circumstances of the refined regime. It would suggest that gains in respect of long-term investments held for many years could be taxable in their entirety upon the introduction of the refined regime. In practice, Singapore continues to maintain a capital versus revenue distinction and, even where the conditions of the Singapore participation exemption are not met, provided any gain upon disposal can be considered capital in nature under case law, the gain is exempt from tax. Hence, this change could put Hong Kong at a significant disadvantage. If, as result of the agreement with the EU, Hong Kong's existing capital versus revenue distinction can no longer be retained under the refined regime, then, as a minimum, there must be a “rebalancing” as at 1 January 2023. The intention must be that any gains accrued before that date, whether or not reflected in the financial statements (given that, in some cases, accounting may be done on a historical cost basis) should be excluded from consideration, even if they are “received” in Hong Kong afterwards. Any capital gains should be taxable only on a prospective basis.

We should also like to seek clarification regarding the deductibility of the acquisition costs in the circumstances where the relevant disposal gains are treated as taxable under the refined regime and the participation exemption is not available. It would clearly be unfavourable to taxpayers if the acquisition costs are considered to be non-deductible due to their capital nature whereas the gains upon disposal are taxed.

Nexus approach for IP income (paragraphs 16 to 17 of the CP)

Given the extremely limited scope for offshore IP income to be able to comply with the nexus approach (essentially only where research and development ("R&D") activities directly connected to patents or equivalents are outsourced to an unrelated party outside of Hong Kong, because carrying out R&D activities in Hong Kong is likely to result in the IP income being regarded as onshore sourced), it seems that, under the refined regime, hardly any taxpayers will be able to claim IP income received in Hong Kong as non-taxable.

Accordingly, as it is not the government's policy objective to generate fiscal revenue through the refined regime, it will be important to ensure that taxpayers losing their offshore claims on IP income will not be taxed excessively. As we have pointed out in the Institute's budget submissions, the prevailing deduction rules for IP-related expenditures are fairly restrictive (e.g., limitations under section 16EC of the IRO with respect to costs of acquiring IP rights covered by sections 16E and 16EA, under certain circumstances, including where the relevant IP rights are purchased from an associate, or where the relevant IP right is, while a licence is in force, used wholly or principally outside Hong Kong by a person other than the taxpayer; no deduction for expenditures on R&D activities outsourced to parties other than R&D institutions; and no deduction for upfront licence fees). We consider, therefore, that it is critical for the government to revisit these rules as soon as possible, to avoid the situation where offshore IP income is effectively subject to profits tax on a gross basis, which will result in a significant tax burden, even if tax credits against foreign taxes paid are available.

In this connection, while the new Hong Kong transfer-pricing framework allows for cost contribution agreements, etc. and the IRD has indicated that contract R&D is acceptable under specified circumstances, the acquisition of base IP continues to be non-deductible in Hong Kong. The commercial reality is that companies in, e.g., the life science, pharma and other high tech industries, routinely acquire intangibles to jumpstart their R&D activities and thus there is a clear nexus to future IP income. Unless they acquire the IP legally and beneficially, often they cannot hire staff, build laboratories, etc., to develop future IP. The non-deductibility of this crucial expenditure has put Hong Kong at a significant disadvantage to other competitors in the region, where a Hong Kong entity is a cost contribution agreement participant (i.e., a regional IP owner/ entity performing DEMPE (development, enhancement, maintenance, protection or exploitation) functions in relation to the IP). This renders other related fiscal measures, such as R&D super-deductions, ineffective.

Separately, since the nexus approach is more compatible with IP preferential regimes that encourage local R&D activities, the government may consider introducing an IP preferential regime for onshore IP income, as part of its strategy to promote Hong Kong as an IP hub. In the event that government is prepared to explore this suggestion, more clarification would be needed in terms of the definition of "qualifying IP assets", e.g., whether they must be registered in Hong Kong.

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Participation exemption (paragraphs 18 to 20 of the CP)

The proposed introduction of a participation exemption, to relieve double taxation on dividends and disposal gains received in Hong Kong under the refined regime, is a welcome initiative.

However, among other things, the proposed participation exemption will be granted only if no more than 50% of the income derived by the investee company is passive income. It is unclear whether the exemption will apply to certain situations where, for example, an overseas intermediate holding company is interposed between the Hong Kong holding company and the underlying active investee company. While the income of the underlying investee company may not comprise any passive income, the income of the intermediate holding company would likely comprise only passive dividend income received from the investee company. In this case, if the intermediate holding company is regarded as the investee company of the Hong Kong holding company, the dividends received by the Hong Kong company from the intermediate company would not then be eligible for the proposed participation exemption in Hong Kong.

In view of the multi-layered corporate structures, which are often set up for valid commercial reasons (e.g., Hong Kong headquartered groups setting up a company to hold regional operations), it needs to be made clear whether the government will adopt a look-through approach in respect of all constituent entities forming part of the MNE group in the ownership chain, in determining whether the participation exemption is applicable. This should be the case, in our view, given that there will also be anti-avoidance measures in place to deal with clear cases of abuse.

Switch-over rule (paragraph 20(a))

Clarification is needed as to whether the proposed switch-over rule would apply to both jurisdictions with comprehensive double taxation agreements ("CDTA") with Hong Kong and non-CDTA jurisdictions.

Reference to the "a foreign jurisdiction the headline tax rate of which is **below 15%**", and how this will be applied, also needs further clarification. In this connection, we would refer to paragraph 8.3 of the e-Tax Guide issued by the Inland Revenue Authority of Singapore, which states that the foreign "headline tax rate" refers to "*the highest corporate tax rate of the foreign country of source in the year the specified foreign income is received…*", i.e., not necessarily the rate applied to the investee company's profits. We recommend that the government adopt a similar definition and state this explicitly in the relevant DIPN/ guidance.

If this is not the approach adopted, the switch-over rule should not be applied in situations where taxation is restricted under a CDTA, as this could lead to a greater total tax cost for taxpayers investing in jurisdictions which have concluded CDTAs with Hong Kong.

Main purpose rule (paragraph 20(b))

Further clarification is required as to whether the "tax advantage" refers to tax advantage in Hong Kong only. If not, it could be difficult for taxpayers to prove that

no tax advantage has been obtained in other jurisdictions and the effort required could be onerous.

Unilateral tax credit (paragraphs 24 to 25 of the CP)

Since some covered taxpayers may suffer double taxation if they do not qualify for exemption under the refined regime (due to, e.g., insufficient economic substance), the CP proposes to introduce unilateral tax credits, such that overseas taxes paid in respect of in-scope offshore passive income received from jurisdictions that have not concluded a CDTA with Hong Kong will be creditable against the Hong Kong tax payable on the same income, under the refined regime.

Generally, under Hong Kong's CDTAs, only dividend withholding taxes, but not the underlying income taxes in respect of the profits out of which the dividends are paid, levied in the overseas jurisdictions concerned, would be creditable in Hong Kong. However, the CP does not indicate whether the proposed unilateral tax credit will cover only dividend withholding taxes or also include the underlying income taxes. In Singapore, the unilateral and bilateral tax credits for dividends received and taxed in Singapore, generally, cover both the dividend withholding taxes and the underlying taxes in respect of the profits out of which the dividends are paid. This approach is also adopted under the Mainland, China – Hong Kong double taxation agreement, where the recipient of the dividend has a shareholding of at least of 10% in the company paying the dividend. As such, we recommend that the government should consider adopting a similar approach and cover both the dividend withholding taxes and the underlying taxes on the relevant profits. Where the proposed unilateral tax credit is more beneficial than the bilateral tax credit, the more beneficial unilateral tax credit should also be applicable to supplement the bilateral tax credit under Hong Kong's CDTAs. Consequently, the unilateral tax credit should not be limited to tax paid in non-CDTA jurisdictions, but should also cover non-Hong Kong tax residents.

The unilateral tax credit regime should take into account both juridical (e.g., withholding tax) and economic double taxation (corporate tax paid by underlying foreign subsidiaries). A look-through approach should be adopted to take into account the corporate tax paid by all constituent entities forming pat of the MNE group in the ownership chain.

According to the CP, the proposed unilateral tax credit will be provided only in respect of in-scope income deemed taxable under the refined regime. In practice, offshore income deemed to be taxable under the refined regime is similar to an onshore income that is subject to overseas taxes and chargeable to Hong Kong tax under section 14 of the IRO. As such, the proposed unilateral foreign tax credit regime should not be restricted to covered taxpayers only. We suggest that it be extended to all taxpayers.

Administrative guidance (paragraph 26 of the CP)

We welcome the fact that the IRD will issue administrative guidance on the refined regime. In considering its application, even though the IRD will look at the totality of facts of each case, affected taxpayers would benefit from further guidance and detailed illustrative examples on key issues. This would help to facilitate greater certainty and consistency, which is an important factor for investors considering

Hong Kong as a possible location for investment. In this regard, we suggest that further guidance be provided in relation to the following issues:

- **Definition of the term "received in Hong Kong" in paragraph 10(a)** – Please refer to the more detailed discussion under the section "Covered income and covered taxpayers", above.

- **Economic substance requirement** – We understand that it would be difficult to state a specific number or threshold establishing that the adequacy test has been met in all cases. Therefore, we suggest that, instead, the IRD provide, as a minimum, some specific guidance for Hong Kong's core traditional and main emerging industries among MNE groups. Instead of the exact number of qualifying employees and exact amount of qualifying expenditure incurred in Hong Kong, an indication of a range of values and/or a proportional formula (if applicable) would still be welcome. In addition, guidance should cover how MNE groups can meet the requirement for adequate ESRs, including the type of activities that are required to be conducted in Hong Kong without affecting the offshore source of the income, and, where they outsource relevant activities to different group companies, how they can fulfil the requirement for adequate monitoring and what supporting documents are needed.

- **Nexus approach for IP income** – Illustrative examples as to how the nexus approach will be applied and how the 30% uplift on the qualifying expenditures will be calculated.

- **Participation exemption for dividends and disposal gains** – We hope to see more detailed rules and guidance on how the 5% shareholding threshold and the 50% of total income threshold will be determined. Illustrative examples would also be helpful.

- **Unilateral tax credit** – Upon the passage of the relevant legislation, DIPN 28 should be revised to reflect the application of unilateral tax credit, under the refined regime. We would hope to see a comprehensive range of illustrative examples and more details on the scope of the unilateral tax credit, e.g., covering dividends, withholding taxes and/or the underlying income taxes in respect of the profits out of which the dividends are paid. For more details, please refer to the section "Unilateral tax credit" above.

Compliance requirement (paragraph 27 of the CP)

According to the CP, a covered taxpayer who has received in-scope offshore passive income that is deemed to be sourced from Hong Kong under the refined regime needs to report the income in its profits tax return for the year of assessment in which the income is received. If the taxpayer has not yet been required to file the return, it should notify the IRD of receipt of the income.

There is a concern that such a notification requirement may exceed the existing notification obligation to inform chargeability to tax under the IRO (i.e., section 51(2) of the IRO). It appears that, if a taxpayer (not receiving a tax return) receives in-scope income, no matter whether the income is chargeable or not, the taxpayer should notify the IRD with the prescribed information. We would like to confirm

whether this understanding is correct.

To reduce the compliance burden on taxpayers, we would propose that taxpayers be relieved from providing the additional information mentioned in paragraphs 27(a) to (g) of the CP, if they are required to file profits tax returns and, at the same time, cannot fulfil the exemption requirement (and, so, are subject to tax under the refined regime). In this case, affected taxpayers who are not able to/ do not wish to claim the exemption could report their taxable passive income directly in their profits tax returns.

Generally, it appears that the amount of information specified in paragraph 27 of the CP, including transaction-based information, could be onerous for taxpayers, especially for taxpayers in sectors such as financial services. This requirement needs be considered carefully, particularly in the light of the government's commitment, referred to above, to minimise the compliance burden on companies.

Despite the above, as the refined regime would introduce, potentially, significant and far-reaching changes to Hong Kong's tax system, we recommend that the government consider introducing suitable transitional arrangements and allow sufficient time for taxpayers to comply with the additional information requests, and be able to gather the necessary data to report, such as information related to offshore/ foreign receipts and payments.

Should you have any questions on this submission, please do not hesitate to contact me at peter@hkicpa.org.hk or on 2287 7084.

Yours faithfully,

Peter Tisman
Director
Advocacy & Practice Development

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