Annual Meeting

The Inland Revenue Department

and

The Hong Kong Institute of Certified Public Accountants
Preamble

As part of the Institute’s regular dialogue with the government to facilitate tax compliance, improve procedural arrangements and to clarify areas of interpretation, representatives of the Institute met the Commissioner of Inland Revenue (“CIR”) and members of his staff in March 2016.

As in the past, the agenda took on board items received from a circulation to members of the Institute prior to the meeting. The minutes of the meeting, prepared by the Inland Revenue Department (“IRD”) are reproduced in full in this Tax Bulletin and should be of assistance in members’ future dealings with the IRD. Part A contains items raised by the Institute and Part B, items raised by IRD.

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2016
ANNUAL MEETING BETWEEN
THE INLAND REVENUE DEPARTMENT AND
THE HONG KONG INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Full Minutes

The 2015/16 annual meeting between the Hong Kong Institute of Certified Public Accountants and the Inland Revenue Department was held on 11 March 2016 at the Inland Revenue Department.

In Attendance

Hong Kong Institute of Certified Public Accountants ("the Institute")

Mr Anthony Tam Chairman, Taxation Faculty Executive Committee
Ms Florence Chan Past Chairperson, Taxation Faculty Executive Committee
Mr K K So Deputy Chairman, Taxation Faculty Executive Committee
Mr Curtis Ng Deputy Chairman, Taxation Faculty Executive Committee
Ms Sarah Chan Member, Taxation Faculty Executive Committee
Mr Edward Lean Member, Taxation Faculty Executive Committee
Mr Peter Tisman Director, Advocacy and Practice Development
Ms Elena Chai Associate Director, Advocacy and Practice Development

Inland Revenue Department ("IRD")

Mr Wong Kuen-fai Commissioner of Inland Revenue
Mr Chiu Kwok-kit Deputy Commissioner of Inland Revenue (Technical)
Mr Tam Tai-pang Deputy Commissioner of Inland Revenue (Operations)
Ms Doris Lee Assistant Commissioner of Inland Revenue
Ms Maria Tsui Assistant Commissioner of Inland Revenue
Ms Connie Chan Assistant Commissioner of Inland Revenue
Ms Mei Yin Chief Assessor (Tax Treaty)
Ms Hui Chiu-po Senior Assessor (Research)
Mr Wong Kuen-fai (“CIR”) welcomed the representatives of the Institute to the meeting, in particular Mr Lean who attended the meeting for the first time. Mr Anthony Tam thanked the IRD for holding the annual meeting. He viewed the annual meeting as an important event which offered a valuable opportunity to clarify technical issues to both members of the Institute and the community as a whole. In addition, he thanked the IRD’s support to the Institute’s events during the past year and he looked forwarded to continuing the cooperation in future. CIR, after thanking Mr Anthony Tam for his kindness, expressed that the IRD always treasured the annual meeting which provided a platform for exchange of views and resolving issues of mutual interest. The meeting then commenced discussion of the agenda.

**PART A - MATTERS RAISED BY THE INSTITUTE**

**Agenda item A1 - Profits tax issues**

**(a) Fair value accounting**

The IRD introduced the administrative measure for the tax treatment of unrealized gains that resulted from the *Nice Cheer* decision in 2013-14, and extended it to the filing of the 2014-15 profits tax returns. Under the administrative measure, the IRD agreed to accept the 2013-14 and 2014-15 profits tax returns to be prepared on a fair value basis, and agreed to re-compute the assessable profits if the taxpayers subsequently adopt the realization basis.

**(i) The Institute would like to seek the IRD’s view on whether or not taxpayers are required to adopt the basis consistently under the interim administrative measure. If yes, would this mean that once the taxpayer adopts the realization basis, he cannot revert to adopt the fair value basis in subsequent years while the interim measure is in place?**

CIR explained that the interim administrative measure aimed to deal with the compliance issues faced by financial institutions or other taxpayers, transacting in financial instruments, with financial statements prepared on a fair value basis (i.e. mark-to-market basis). Under the measure, they were not required to re-compute accounting profits from the fair value basis to the realization basis for taxation purposes according to the judgment in *Nice Cheer*. He indicated that the fair value basis for computing assessable profits was expected to be consistently followed so that profits would not be dropped out from taxation simply because of a change in basis (i.e. from the fair value to the realization basis and vice versa).

CIR said that, as explained on the IRD’s website, it was agreed that assessable profits, computed on a fair value basis, could be recomputed if taxpayers subsequently adopted the realization basis. However, any request for re-computation should be made within the time limits and parameters laid down in sections 60 or 70A of the Inland Revenue Ordinance (“IRO”).
CIR pointed out that taxpayers in any event should take measures to ensure that all assessable profits were fully and timely reported for taxation. He remarked that any act to omit profits from returns (either intentionally or without reasonable excuse) by changing the basis to compute assessable profits might be subject to penalty.

(ii) To help reduce uncertainty surrounding the issue, the Institute would appreciate it if the IRD could provide guidance and advise on the progress of the review on the issues arising from the *Nice Cheer* judgment. In particular, would the administrative measure be further extended to 2015-16? Or would there be a change in law and if so, what might be the potential changes?

CIR told the meeting that the IRD had already announced on its website that the interim administrative measure would continue in the filing of 2015/16 profits tax returns. While the IRD supported a change in legislation that allowed computing assessable profits on fair value basis, it was recommended that an election for computing assessable profits on a fair value basis should be made irrevocable and should have effect for the year of change and all subsequent years of assessment.

Ms Florence Chan ("Ms Chan") asked whether an election for changing the basis to re-compute assessable profits on a fair value basis would be allowed in a reverse situation whereby a taxpayer had already adopted a realization basis. CIR replied in the negative and said that the proposed election could only be made once. On this point, Mr Tisman sought clarification on whether such one-off election would be applied while the administrative measure was in place. CIR responded that the current measure was only an interim administrative measure and the policy decision for a change in the legislation was pending. CIR said that subject to the policy decision, the election arrangement would be part of the legislative proposals.

(b) **Amalgamation without sale of assets**

The Institute notes that the IRD has issued guidance on its assessing practice in relation to the tax issues arising from court-free amalgamations ("the Guidance"), and notes that for amalgamation without sale of assets, the amalgamated company would be deemed to succeed the assets from the amalgamating company at their tax written down values and would be allowed to continue claiming tax relief on these values. The “succession” approach is however, not extended to trading stock. The Institute would ask the IRD to consider extending the same approach to trading stock, where the items involved continue to be the trading stock of the amalgamated company.
In any case, where the trading stock is deemed to have been realized by the amalgamating company at open market value, the Institute would like to know whether the amalgamated company would be deemed to have incurred costs for the acquisition of the same items at the same open market value for tax purposes.

CIR said that since each amalgamating company would cease to exist upon amalgamation under section 685(3)(b) of the Companies Ordinance (Cap. 622) (“CO”), the IRD had to treat each amalgamating company as having ceased to carry on its trade or business on the day immediately before the amalgamation for the purposes of the IRO. That was explained under agenda item A1(a) of the 2015 annual meeting. Section 15C of the IRO, concerning the valuation of trading stock on cessation of business, would then be applied to each amalgamating company and its trading stock would be taken to have realized at open market value on the day immediately before the amalgamation.

CIR explained that if the amalgamated company continued to carry on the same trade or business of the amalgamating company upon and after the amalgamation, the same open market value would be used to compute its assessable profits on the subsequent disposal of the trading stock.

In respect of section 685(3)(b) of the CO, Mr Lean held the view that the section meant each amalgamating company ceased to exist as a separate company on the date of amalgamation, but they amalgamated together and continued as one company. In Mr Lean’s view, there was no cessation of the trade or business. He then questioned the different tax treatments between the trading stock and capital assets, even if an amalgamating company was regarded as having ceased to exist. He noted the difference: (a) section 15C would be applied to the trading stock and the amalgamating company was deemed to have realized its trading stock at open market value; and (b) capital assets succeeded by the amalgamated company would not constitute a sale and there would not be any balancing charge or allowance.

In response, CIR explained that since the amalgamating companies had ceased to exist, there could be a disposal of the trading stock and capital assets from the amalgamating companies to the amalgamated company. Therefore, the relevant cessation provisions under the IRO became applicable. Mr Chiu supplemented that the “succession” approach was only applicable to the capital assets succeeded from the amalgamating companies. He elaborated that the amalgamated company would qualify to claim annual depreciation allowances, which should be based on the reducing value of the plant or machinery succeeded, without any balancing charge or balancing allowance. He pointed out that since industrial building allowance or commercial building allowance was granted to a person who was entitled to the relevant interest in relation to capital expenditure incurred, the amalgamated company should be able to claim annual allowances in respect of industrial building or commercial building succeeded from the amalgamating company.

While Mr Chiu recognized that there could be two ways to interpret section 685(3)(b)
of the CO, he remarked that the IRD’s stance was explained under agenda item A1(a) of the 2015 annual meeting. With the support of the leading authority in Hong Kong, *Hong Kong Company Law 2 – Legislation and Commentary*, the IRD held the view that each amalgamating company would cease to exist on the date of amalgamation and the new amalgamated company would take over all the properties, rights, liabilities and obligations of the amalgamating companies. Mr Chiu also mentioned that tax losses were specific to a company and could not be succeeded nor transferred to other group companies. He said that the IRO did not provide for group loss relief and deduction for acquired losses through court-free amalgamation procedure. He added that subject to the availability of legislative timeslot, the IRD supported the enactment of specific legislation concerning the tax treatment on court-free amalgamation and, for this purpose, the IRD was studying the specific tax legislation in other jurisdictions such as Singapore and New Zealand.

Mr Anthony Tam commented that there was an imminent need to amend the IRO to address various tax issues arising from a court-free amalgamation of companies in Hong Kong so as to remove uncertainties. Ms Chan echoed that an amendment was necessary to clarify the tax treatment of trading stock succeeded in amalgamation. She was concerned that the words “transferred for valuable consideration” in section 15C created uncertainty when sale and purchase had not taken place in the court-free amalgamation. Mr Lean took the view that, under the CO, it was not permitted to pay any consideration for the acquisition of the business assets and liabilities of the amalgamating companies in an amalgamation. CIR noted the issue and said that the legislative proposals in relation to tax issues arising from amalgamations had been put forward but a legislative time slot was not available. He continued by saying that there would be consultations with professional bodies on any legislative proposals.

Mr Anthony Tam asked whether the Institute could submit suggestions on the issue. Mr Chiu replied that the IRD always welcomed the Institute to give its views. He further said that the IRD would consider providing further details in the Guidance.

(c) *Tax losses in amalgamations*

Under the Guidance, brought-forward tax losses of the "amalgamating company" may be used if a "same business" test is satisfied. The Institute would like to ask whether legislative changes will be proposed to give effect to this tax treatment, including a definition of "same business", in the IRO, as it is unclear how specific conditions for tax loss carry-forward such as this could be introduced without amendment of the IRO? We note that the assessing practice is similar to section 34C of the Singapore Income Tax Act, which was enacted to provide for the Singapore income tax treatment of an amalgamation of companies.
CIR recognized that enacted legislative provisions could best clarify and resolve issues arising from court-free amalgamations. He disclosed that towards that end, the IRD and the Financial Services and the Treasury Bureau were working closely together. Legislative changes to the IRO would be introduced into the Legislative Council when a time slot was available.

CIR said that the same trade requirement was to restrict tax losses available for set-off. He explained that such a requirement was not new and had been adopted in common law jurisdictions like Australia and Singapore to deal with succeeded losses in amalgamation. However, it might not be desirable to have statutory definition since the ultimate analysis was a question of fact per the judgment delivered by Walton J in *Rolls-Royce Motors Ltd v Bamford* [1976] STC 162. CIR further pointed out that the issue on whether there were two different businesses had been considered in *Southtime Ltd v CIR* [2002] 2 HKLRD 275.

Regarding the assessing practice itself, we have the following observations and questions:

(i) The use of the terms "amalgamating" and "amalgamated" companies in the Guidance are confusing and appear to differ from the use of those terms in the CO. It appears from the Guidance that the IRD considers there to be a surviving company – referred to as the "amalgamated company" both before and after the amalgamation. We do not understand this to be the position as a matter of company law and believe that references in the CO to "amalgamating companies" are to all companies that will amalgamate and references to the "amalgamated company" are to the resultant entity following amalgamation. It would be useful, therefore, if the IRD would clarify the meaning of the relevant terms in the Guidance, including "amalgamated company", "amalgamating company", "financial resources".

CIR said the IRD took the view that the use of the terms “amalgamating” and “amalgamated” companies in the Guidance should be clear and consistent with their meanings in Division 3 of Part 13 of the CO though the IRD would consider whether clarifications were required.

CIR elaborated that the adequate financial resources requirement was to prevent the transfer of profits from one amalgamating company (say, Co A) with assessable profits to another amalgamating company (say, Co B) with substantial tax losses. He said that Co B would in a sense end up as the amalgamated company. CIR further elaborated that such a set-off of losses would not be allowed if Co B did not have adequate financial resources to acquire Co A other than through a court-free amalgamation.

CIR added that the term “financial resources” was broad and would include capital, liquid assets and cash. He said that the term in the Guidance
excluded “intra-group loans” and IRD would also consider the ability of Co B to raise funds from independent third parties when applying the test. CIR suggested that an application for an advance ruling should be considered if the facts were complex, involving details which were not obvious.

(ii) Where the "amalgamated company" has brought-forward tax losses from before the amalgamation, then it will not be able to offset them post-amalgamation if it did not have adequate financial resources (excluding intra-group loans) to purchase the business of the "amalgamating company". We would like to clarify the rationale for not allowing the amalgamated company to use its brought-forward losses against profits derived from the same trade or business that it was carrying on prior to amalgamation. This is important, so that the taxpayer is not in a worse position than it would have been absent the amalgamation.

CIR said that the reason for having the adequate financial resources requirement had been explained in (i) above. He advised that if Co B in (i) above failed to meet the financial resource requirement, the tax losses brought forward could not be used to set off against the profits derived from the same trade or business succeeded from Co A in (i) above. He continued, explaining that the failure would not affect the set-off against the profits derived by Co B from its own trade or business. CIR said that the IRD would consider providing further details, if necessary, concerning the treatment of losses in the Guidance.

(iii) Where the "amalgamating company" has brought-forward losses these may be offset against profits derived from the same trade or business carried on by that company prior to the amalgamation. The Institute would like to know the IRD's assessing practice for determining these profits. Once the amalgamation has been effected there will be one company and it may be difficult from a practical point of view to determine the profits derived from the trade or business that was previously carried on by the amalgamating company. This will be particularly true where the nature of the businesses carried on by the amalgamating and amalgamated companies is similar and the businesses are integrated from a management and reporting perspective once amalgamated. Furthermore, as trades and businesses change over time (e.g., markets, products, etc), how will the IRD determine whether the profits are still from the same trade or business?

As explained in (c) above, CIR said the same trade requirement was to restrict the transfer of tax losses from a loss making group company to a profit making group company. He explained that such a requirement was adopted in other tax jurisdictions to deal with losses succeeded in amalgamation and the meaning of the word “same” in the phrase “same trade or business” imported
identity and not similarity (i.e. it meant an identical trade or business). He emphasized that the ultimate analysis would be a question of fact. He referred to Rolls-Royce Motors Ltd v Bamford [1976] STC 162, in which Walton J distinguished an organic growth of a trade and a sudden and dramatic change brought about by either the acquisition or the loss of activities on a considerable scale. CIR quoted Walton J’s explanation on:

the proper comparison at page 185d-f:

“..., if there is in substance a complete division of the trade of the company into two separate parts, notwithstanding that trade of the same general nature is carried on thereafter by each of the two now separate entities, it appears to me that neither of them is carrying on the same trade as the composite whole formerly carried on. Counsel for the Crown refined this approach by pointing out that the opening words of the Income and Corporation Taxes Act 1970, s 177(1), focussed attention on the trade being carried on by the company in the accounting period in which the loss had been made, and it is that trade which has to be carried on for the loss relief to be available. Thus, he submitted, counsel for the taxpayer company’s argument that one had to look at the whole history of the company’s trading from its inception to see what was the true nature of its trade was wholly misconceived.

I think there is considerable force in that submission and I therefore conclude that the comparison which has to be made is between the trade actually carried on by the company in the accounting periods in which it was making the losses in question (1969, 1970 and a period from 1 January 1971 on) and the trade carried on by the taxpayer company, and not between the ‘historic trade’ of the company and that of the taxpayer company. If this is the correct approach, then it appears to me that the ‘question of degree’ approach, which was that adopted by the commissioners, was the correct one.”

And at page 186j:

“Consider, the losses of which the taxpayer company seeks to claim the benefit were incurred in a trade which, whatever it was, included the development of the RB 211 engine. That engine, after the splitting of the company, continued to be developed by Rolls-Royce (1971) Ltd, and not by the taxpayer company. Thus, if anybody could be said to be carrying on the same trade as that in which the losses were incurred, it would appear to be Rolls-Royce (1971) Ltd and not the taxpayer company.”
(iv) Where the IRD considers that brought-forward tax losses may be used, the Institute would also like to clarify if there would be any restriction on the order in which pre-amalgamation or post-amalgamation losses may be used?

CIR replied that the pre-amalgamation tax losses sustained and brought forward from the amalgamating company could only be set off against the profits of the amalgamated company derived from the same trade or business succeeded from the amalgamating company, until the tax losses were fully utilized. He said that the amalgamated company would then use its post-amalgamation losses to set off against its post-amalgamation profits.

Mr Ng illustrated with an example in which there was an actual sale of business within a group of companies. He took the view that, under the current provisions of the IRO, a group company with tax losses could acquire the business of another group company with assessable profits and then set-off its tax losses against the profits of the acquired business. He said that if such transaction was carried out for the purpose of obtaining tax benefits, the IRD could invoke section 61A of the IRO to deny the set-off. He queried why there should be additional requirements to restrict the set-off of pre-amalgamation tax losses after amalgamation. He considered that such requirements might discourage taxpayers from carrying out a court-free amalgamation, thereby defeating the original legislative intent which was to introduce an efficient and simpler court-free regime under the CO. Mr Lean, Mr So and Ms Chan also voiced out that they had similar concerns. Given the existing general anti-avoidance provisions could be relied upon to combat tax avoidance, they considered it not necessary to have additional requirements, such as the "same trade or business" requirement, to restrict the set-off of tax losses.

In response, CIR advised that the rationale of introducing the same trade requirement and the adequate financial resources requirement in the Guidance was to remove uncertainties. He stressed that the IRD had to be cautious about these tax losses. Mr Chiu added that despite the existence of the general anti-avoidance provisions under the IRO, it would be necessary to have specific anti-avoidance provisions to give clarity to the law. Ms Lee remarked that a number of favourable rulings had been given in relation to court-free amalgamations. While she noticed that attempts were made to reduce assessable profits through the use of pre-amalgamation losses in a few cases, she considered the situation not serious. Mr Chiu concluded that there would be an issue only if tax losses were material in quantum.

Ms Chan took the view that if specific legislations on court-free amalgamation were required to be enacted, there might be a need to strike a balance between the certainty and efficiency so as to formulate more reasonable anti-avoidance provisions in light of the original intent of the new CO. Mr Chiu responded that stakeholders would be consulted on the issue. He assured
the meeting that the Guidance was for general reference only and the facts of each case would be examined carefully before reaching a conclusion.

Mr Anthony Tam commented that it would be useful if the “same trade requirement” could be elaborated in the Guidance. He cited an example that an amalgamating company was a wholesaler and the amalgamated company was a retailer. He asked whether the “same trade” requirement was satisfied given that the same product was sold before and after amalgamation. CIR explained that the word “same trade” meant an identical trade but the ultimate analysis would be a question of fact per the Rolls-Royce case. He considered that the same trade requirement had not been met since the amalgamated company ceased to carry on the wholesale trade succeeded from the amalgamating company. Mr Tam asked what the position would be where an amalgamating company had two businesses. CIR replied that this was the situation in Rolls-Royce and Southtime cases and that specific businesses could be tracked through to the amalgamated company.

(d) Tax filing in the year of amalgamation

We note that some taxpayers have received a letter on the tax filing requirements in the year of amalgamation from the IRD. Amalgamating companies need to file cessation returns with the accounts for the period from the last financial year-end to the effective amalgamation date. This appears to be consistent with the recently published guidance on the IRD assessing practice in court-free amalgamations. The period could be more or less than twelve months, subject to the accounting year-end. On the other hand, the amalgamated company needs to file a profits tax return only for the post-amalgamation profits/losses of the amalgamating company/companies. The letter also requests schedules showing the tax treatments of the assets and liabilities succeeded by the amalgamated company from the amalgamating company/companies.

However, this approach seems to be at odds with accounting practice. Generally, the amalgamating and amalgamated companies would adopt the same accounting year-end. Moreover, under merger accounting, the full year’s operating results of the amalgamating company/companies for the year of amalgamation (i.e., including the operating pre-amalgamation results) will be included in the accounts of the amalgamated company for the year concerned.

As such, where there are no pre-amalgamating losses in the amalgamating and amalgamated companies, the Institute would ask the IRD to consider not requiring the amalgamating company to file a cessation return and only requiring the amalgamated company to file its annual tax return for the year of amalgamation based on the full-year merger accounts. In other words, any tax assessments for the year of amalgamation for the amalgamating and amalgamated companies would be combined and issued in the amalgamated company’s name, given that the amalgamating
companies would have ceased to exist as a separate legal entity.

For taxpayers required to file profits tax returns as outlined in the first paragraph, the Institute would like to clarify whether certified management accounts will be accepted in support of the returns.

CIR said that prior to the court-free amalgamation, as a matter of fact and law, the amalgamating companies were separate and distinct entities, each of which had to observe the obligations imposed by the IRO. He pointed out that the accounting guideline on merger accounting for common control combinations was directed towards the preparation of financial statements and not tax computations. He remarked that the accounting guideline and the Guidance served different purposes and there was no legal basis for tax assessments prior to the amalgamation to be combined.

Though in general certified management accounts alone would not be sufficient for the ascertainment of profits chargeable to tax, CIR agreed to review the situation.

Mr Lean commented the amalgamated company was only required to prepare one set of audited financial statements in the year of amalgamation under the prevailing Hong Kong accounting standards. This set would incorporate the financial information of the amalgamating company into its own as if the two were amalgamated from the start of the accounting year. He asked whether the IRD would accept one set of audited financial statements together with two sets of certified management accounts to support the profits tax returns of the amalgamating and the amalgamated companies instead. Ms Chan supplemented that only one set of audited financial statements covering the amalgamating company and the amalgamated company was required under the CO. CIR took note of this point while Mr Chiu said that the IRD would review the Guidance and try to find a solution.

[Post-meeting note: The IRD subsequently updated the Guidance on its website on 16 December 2016 (http://www.ird.gov.hk/eng/tax/bus_cfa.htm)]

(e) Examples on the debt-versus-equity characterization of a perpetual note

Regarding the tax treatment of perpetual notes with debt and equity features, the Institute welcome the list of factors to be considered, which was provided in response to agenda item A1(e) of the 2015 annual meeting.

The Institute would like to request if the IRD could consider providing further guidance in the form of illustrative examples, through a Departmental Interpretation and Practice Notes ("DIPN") or FAQs, to help guide taxpayers in analyzing how the relevant factors would apply in determining whether a perpetual note was a debt or equity instrument. It
is noted that the guide on the income tax treatment of hybrid instruments issued by the Inland Revenue Authority of Singapore outlines, for instance, the tax treatment for distributions on the perpetual notes with illustrative examples.

Mr Chiu encouraged members of the Institute to provide the IRD with detailed facts of the cases they had encountered. He said that the IRD after examining the cases would then decide whether further and better guidance should be provided in the form of illustrative examples. He said that if there were doubts, an application for an advance ruling could be made before the issue of the securities.

Ms Chan asked whether the IRD would issue a guideline with examples on tax treatments of perpetual notes. Mr Chiu agreed to consider her suggestion if members of the Institute could provide the IRD with facts of actual cases.

(f) Charter hire income from the leasing of aircraft or ships

Following agenda item A1(h)(i) of the 2015 annual meeting, the Institute would like to seek clarification on the treatment of charter-hire income derived by owners of aircraft or ship.

For example, if an aircraft owner derives leasing or charter-hire income under a charter-party agreement, could it fall under the sections 23C or 23D regime, and would a different treatment prevail if the aircraft owner leases or charters out the aircraft to a commercial public airline based in Hong Kong, and at the same time, leases out its private jets to its customers? In addition, the Institute would also like to ask how the term “a business of chartering”, within the definition of “business as an owner of aircraft” under sections 23C and 23D, would be interpreted?

Besides this, what would be the treatment for a ship owner who derives leasing or charter-hire income under a charter-party agreement from leasing out its ocean-going ships?

Mr Chiu clarified that sections 23C and 23D applied to a person who carried on a “business as an owner of aircraft” which was defined to mean a business of chartering or operating aircraft, but did not include dealing in aircraft or agency business in connection with air transport. He pointed out that the term “owner” was defined to include a charterer of an aircraft under a charter-party and the term “charter hire” included sums earned or accrued to a charterer under a charter-party by demise in respect of the operation of the aircraft. He explained that only those persons who were providing transportation services, as aircraft operators, for the carriage by air of passengers, cargo or mail would be assessed under these two sections. Mr. Chiu continued, saying that sections 23C and 23D applied to owner operators or charterer operators of aircraft. He emphasized that the business of an aircraft operator should be distinguished from the business of equipment leasing.
Mr Chiu advised that when determining whether sections 23C and 23D were applicable, the crux of the matter was whether the income was derived from the business of operating aircraft (i.e. the income was derived in the course of the business of operating aircraft or from an incidental or ancillary activity of the business of operating aircraft). He elaborated that it did not matter whether the owner operator chartered the aircraft to a commercial public airline based in Hong Kong or the private jet to its customers. He explained the different tax provisions: (a) if the aircraft operator carried on a chartering business, its charter-hire income had to be taxed in accordance with section 23C or 23D; and (b) if the aircraft owner, not being an operator, was just engaged in pure leasing activities, the rental income derived from such activities should be chargeable under section 14 of the IRO (i.e. the “operation test” should apply, meaning “one looks to see what the taxpayer has done to earn the profit in question and where he has done it”). He mentioned that in the case of an aircraft leasing business carried on in Hong Kong, the profits arose from operations like investment assessment, fund raising, procurement of aircraft, soliciting lessees, documentation, maintenance, repair, etc. He stressed that the place where the aircraft landed or took off was not an appropriate test for determining the source of the rental income.

Mr Chiu further indicated that the aforesaid interpretation on chartering business was also applicable in the context of a ship owner. He said that for a ship owner operating a ship for carriage of passengers and mails (i.e. not pure leasing business), the charter hire income in respect of the operation of ships outside the waters of Hong Kong and river trade waters, or commencing from Hong Kong and proceeding to sea, was not chargeable to profits tax under section 23B. He concluded that similar to the case of aircraft owner mentioned above, the leasing rental derived from a pure ship leasing business carried on in Hong Kong should be chargeable under section 14 even though the ship concerned was an ocean-going ship.

Mr Chiu remarked that the Chief Executive in the 2016 Policy Address and the Financial Secretary in the 2016-17 Budget Speech had announced that the Government would examine the use of tax concession to boost aircraft leasing business and towards that end, the Government would conduct research, consult the industry and draft the legislative proposals.

(g) Partnership's tax losses

According to sections 19C(2) and (3), losses of a partnership are allocated to each individual partner and the partners can carry forward the allocated losses to set off against his share of future assessable profits of the partnership. In other words, losses incurred by a partnership are generally dealt with at the individual partners' level, not within the partnership.
However, our members have seen the IRD adopting two different approaches in setting off the partnership tax losses against future assessable profits:

**Approach 1 – at individual partner's level**

<table>
<thead>
<tr>
<th>Partnership X</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Overall</th>
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<td>Partner B</td>
<td>($600)</td>
<td>$500</td>
<td>($100)</td>
</tr>
<tr>
<td>Partner C (joined in Year 2)</td>
<td>-</td>
<td>$500</td>
<td>$500</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>($1,200)</td>
<td>$1,500</td>
<td>$300</td>
</tr>
</tbody>
</table>

In Year 1, Partnership X had two individual partners, A and B, and it generated tax losses of ($1,200). In Year 2, a new partner C, joined the partnership and it derived assessable profits of $1,500. All partners shared the profits/losses equally, and no partners elected for personal assessment.

In Year 2, the IRD issued an assessment with assessable profits of $500 in the name of Partnership X, and a statement of loss with tax losses of ($200) to be carried forward.

Under this approach, the partnership's Year 1 losses were allocated to the partners and offset against each partner's share of Year 2 profits. The assessable profits of $500 in Year 2 represented the shared profits of Partner C, who only joined in Year 2 and had no previous tax losses to offset his shared profits.

**Approach 2 – at partnership's level**

<table>
<thead>
<tr>
<th>Partnership Y</th>
<th>Year 1</th>
<th>Year 2</th>
<th>Overall</th>
</tr>
</thead>
<tbody>
<tr>
<td>Partner D</td>
<td>($600)</td>
<td>$100</td>
<td>($500)</td>
</tr>
<tr>
<td>Partner E</td>
<td>($600)</td>
<td>$100</td>
<td>($500)</td>
</tr>
<tr>
<td>Partner F (joined in Year 2)</td>
<td>-</td>
<td>$100</td>
<td>$100</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>($1,200)</td>
<td>$300</td>
<td>($900)</td>
</tr>
</tbody>
</table>

In Year 1, Partnership Y had two partners, D and E, and it generated tax losses of ($1,200). In Year 2, a new partner F, joined the partnership and it derived assessable profits of $300.

In Year 2, the IRD issued a statement of loss in the name of Partnership Y with tax losses of ($900) to be carried forward. No tax was payable in Year 2.

Under this approach, the partnership's tax losses in Year 1 were entirely used to offset the assessable profits in Year 2, and Partner F's shared profits were offset by the tax losses of other partners.

Our members have seen both approaches, and the Institute would like to clarify with the IRD as to the situations, under which Approach 1 or 2 would be adopted.
Ms Lee said that section 19C(2) provided that where an individual incurred a share of loss in a partnership, that loss amount should be carried forward and set-off against his share of assessable profits of the partnership. The provision was applicable unless that individual had elected for personal assessment. She added that it was clear that Approach 1 was the correct approach.

Ms Lee explained that the Assessor in general would prepare an allocation of assessable profits or adjusted loss for each partnership tax computation. There might be, however, circumstances, such as where the assessment was estimated under section 59(3), in which details of partnership changes or profit-sharing ratio were not readily available. In those isolated cases, the Assessor might have to resort to Approach 2.

Ms Lee further urged tax practitioners to provide full details in the partnership returns. She stressed that it would be best if an allocation of profit or loss was included to facilitate checking and prompt assessment.

(h) Tax treatment of accounting standards

The Institute would like to ask the tax implications of the following accounting standards:

(i) Hong Kong Financial Reporting Standard ("HKFRS") 15

In view that HKFRS15 “Revenue from contracts with customers” will be effective on 1 January 2018, the Institute would like to ask if the IRD would consider providing guidance on the tax implications arising from the adoption of the standard through a DIPN, and would there be a consultation process prior to issuing the DIPN.

Ms Lee responded that the core principle of HKFRS 15 was that an entity had to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflected the consideration to which the entity expected to be entitled in exchange for those goods or services. An entity recognized revenue in accordance with that core principle by applying several steps: (1) identify the contract with a customer; (2) identify the performance obligations in the contract; (3) determine the transaction price; (4) allocate the transaction price to the performance obligations in the contract; and (5) recognize revenue when or as the entity satisfies a performance obligation.

Ms Lee advised that subject to the provisions of the IRO, the treatments set out in HKFRS 15 for the recognition of revenue from contracts with customers would generally be accepted by the IRD. In that premise, it was not necessary to issue
any tax guidance. On the other hand, she welcomed the Institute to send its views to the IRD on any specific issues that required closer examination.

(ii) Upcoming standard on leases

Following the IASB’s project update on definition of leases in October 2015, the new leases standard is expected to be effective from 1 January 2019. Under the new standard, lessees would be required to reflect leases as financings and record them on the balance sheet as an asset and a lease obligation, including operating leases under the current standard. In this regard, the Institute would like to ask if the IRD would consider providing more guidance on the tax implications arising from the new standard, e.g., the deduction of lease payments.

Ms Lee replied that as a matter of law, the legal form of a transaction would determine its treatment under the IRO. If an accounting standard did not align with the form of the transaction, the form of the transaction would generally prevail. She said deduction of expenses was governed by sections 16 and 17 of the IRO. She said that new accounting standards were directed towards the preparation of financial statements in order to give investors and other outsiders a true and fair view of the state of affairs of a company and in particular its financial position and profitability. They were not directed towards tax computations: Lord Millett NPJ in Nice Cheer Investment Limited v CIR, (2013) 16 HKCFAR 813 at 833.

In respect of IFRS 16, a new accounting standard for leases, issued by IASB on 13 January 2016, Ms Lee referred to the objective of the standard which was to give “a basis for users of financial statements to assess the effect that leases have on the financial position, financial performance and cash flows of an entity”. The standard introduced a single accounting model for lessees which (1) removed the classification of leases as operating leases or finance leases and (2) required the recognition of lease assets (i.e. right-of-use assets) and lease liabilities in balance sheets, and depreciation of lease assets and interest on lease liabilities in income statements. For lessors, they would continue to adopt the two classifications of leases and account for them differently in the same manner as per the existing IAS 17.

Ms Lee told the meeting that since IFRS 16 was only recently released, the IRD would require time to study its tax implications. She again welcomed the Institute to send its views to the IRD on any specific issues that required closer examination.
**Agenda item A2 - Salaries tax issues**

(a) **Employer’s filing obligations in a group restructuring**

The Institute would like to seek the IRD’s view regarding the tax filing obligations of employers in the following scenarios.

Following a group restructuring exercise, certain employees of Hong Kong Company A (“Co A”) were transferred to its fellow subsidiary, Hong Kong Company B (“Co B”), effective, say 1 October 2015. There were no changes to the employment terms and conditions for the employees (accrued benefits on retirement schemes would be rolled over and Co B would recognize all prior years of service with Co A for calculating the retirement benefits).

(i) For tax filing purposes, would the IRD agree that there was no change of employment for these employees?

As such, Co A would not be required to lodge Form IR56F for the employees transferred to Co B. Correspondingly, Co B would not be required to lodge IR56E for the employees transferred from Co A. Co B would then lodge Form IR56B, as if Co B was the employer throughout the year, reporting all the remuneration received by the employees for the year ended 31 March 2016, including the pre-transfer remuneration received from Co A between 1 April 2015 to 30 September 2015. For employees who remained in or left Co A, the normal rules would apply, whereby Co A would respectively lodge Forms IR56B or IR56F.

To avail themselves of the above tax treatment, Co A and Co B would only be required to give prior written notice to the IRD, providing details of the employment arrangements and the relevant employees, pursuant to the group restructuring.

Ms Tsui said that whether there was a change of employment was a question of fact to be determined by taking into account all the circumstances of the case. The facts that there were no changes to the employment terms and condition for the employees transferred from Co A to Co B was a relevant but not conclusive factor. The transfer of employees of Co A to Co B on 1 October 2015 following the group restructuring exercise, prima facie, represented a termination of such employees’ employment with Co A and a commencement of their employment with Co B. She advised that pursuant to the provisions of section 52 of the IRO, Co A and Co B were respectively required to file Forms IR56F and IR56E for these transferred employees.

Ms Tsui went on to say that for administrative convenience and to streamline the employer’s income reporting requirements for staff transfers within group companies, the IRD was prepared to consider on a case by case basis upon application to dispense with such filing of Forms IR56F and IR56E by the
transferor company and the transferee company respectively provided that:

(a) there was in fact continuous employment on the part of the staff concerned after the inter-group transfer; and

(b) the transferee company undertook to include in its Forms IR56B in respect of these transferred employees all their emoluments covering the whole basis period for the year of assessment in which the transfer occurred, including those emoluments from the transferor company up to the date of transfer, as if there had been no change of employment.

Ms Tsui advised that in making the application, the transferor company and the transferee company had to jointly give prior written notice to the IRD of the group restructuring exercise and provided their file reference numbers with the IRD, details of the employment arrangements, identities (name and Hong Kong Identity Card number) of each of the transferred employees and an undertaking by the transferee company that it would file for each of the transferred employees a Form IR56B for the year of transfer covering his/her emoluments earned both before and after the transfer. This meant that no employment income would be left unreported.

Ms Tsui supplemented that regarding those employees who were not transferred to the transferee company, the transferor company should undertake the usual employer’s tax filing obligations under the IRO.

(ii) Similarly, would the IRD agree that the above practice would also apply to situations involving a merger or an amalgamation of companies pursuant to either overseas or Hong Kong laws. This means that the entities that ceased to exist would not be required to lodge Form IR56F; the surviving entity would not be required to lodge Form IR56E, but would report all the remuneration received by the employees concerned for the whole of the relevant year in Form IR56B. For those employees who left the ceased entities prior to, or upon the merger or amalgamation, the normal rules would apply, whereby the ceased entities would lodge Forms IR56F.

Ms Tsui said that the practice in part (i) above was also applicable to merger or amalgamation of companies pursuant to the laws of Hong Kong or an overseas jurisdiction.
(b) Taxation of deferred shares

In an outbound employee case, paragraph 67 of DIPN 38 states “...If the “Back End” approach is applicable and if the terms of the award clearly state that the vesting of the shares will depend on a period of employment, the value of the shares attributable to the vesting period before his transfer outside Hong Kong should be chargeable to tax. However, there may be situations in which a taxpayer’s entitlement to receive the vested shares is not affected by his resignation. In other words, if the taxpayer will still receive shares under the award after his resignation, the value of the shares should be included in the year of resignation...”.

With reference to agenda item A2(b) of the 2013 annual meeting where example 2 illustrated the apportionment for an inbound employee case, the Institute would like to confirm that the service or performance period of an outbound employee prior to the grant date would be excluded when computing the “vesting period” to determine the assessable amount.

Ms Tsui clarified that for the purposes of determining the assessable amount of share award benefits under the IRO, the “vesting period”, as stated in paragraph 61 of DIPN 38, was taken to mean “the period from the date that the share award is granted to an employee to the date immediately before the date that the employee is entitled to ownership of the shares free of all conditions.” This being so, she confirmed that the service or performance period of an outbound employee prior to the grant date would not be included when computing the “vesting period” to determine the assessable amount.

(c) Taxation of termination payment

Currently, if a termination payment is made according to the Hong Kong Employment Ordinance (Cap. 57), the IRD will automatically exempt such payment from Hong Kong salaries tax. The Institute would like to ask for the IRD’s views where such payment was made pursuant to the law of another jurisdiction (e.g., a person having a Canadian employment with employment services in Hong Kong was made redundant and received a termination payment under the Canadian law)?

Ms Tsui stated that it had always been the practice of the IRD to accept a termination payment in form of severance payment or long service payment calculated under the Employment Ordinance (Cap. 57) (“EO”) as not chargeable to salaries tax. She remarked that excessive portion over the statutory amount might be chargeable to salaries tax, if such excess was in fact reward for services rendered.

Ms Tsui said the reasons why the IRD took the view that severance payment received by an employee under the EO should not be assessable as “income from employment” for Hong Kong salaries tax purposes were fully explained under agenda
item A2(c)(ii) of the 2013 annual meeting.

As regards long service payment, Ms Tsui advised that it was prima facie an “income from employment” assessable to salaries tax. However, having taken into account the potential hardship for a taxpayer who had lost his employment or resigned for health reasons or old age and the payment was intended as some form of provision for his future, it had been the established practice of the IRD not to assess to salaries tax long service payment paid in accordance with the EO. She reiterated that any excess over the statutory amount might be chargeable to salaries tax, if such excess was in fact reward for services rendered.

Ms Tsui said that for termination payment received pursuant to the law of another jurisdiction, the onus was on the taxpayer to prove to the IRD’s satisfaction that its nature was not an “income from employment” or was sufficiently similar to the statutory severance payment or long service payment under the EO and therefore not chargeable to Hong Kong salaries tax.

(d) **Application of the "proportionate benefit rule"**

Upon termination of service, an employer is obliged to report the amount of accrued benefits received or taken to have been received from a recognized occupational retirement scheme ("ROR scheme") or a mandatory provident fund scheme ("MPF scheme") by an employee in excess of the proportionate benefit.

The example for calculating “The Proportionate Benefit Rule for MPF Schemes” in the IRD’s pamphlet “Employer’s Tax Obligation under MPF schemes and ROR schemes” (Note 1 on page 7), states that “For an MPF Scheme, the accrued benefit is equal to the employer’s voluntary contributions” (i.e., explicitly excluding investment income attributable to the employer’s voluntary contributions).

However, the example for “The Proportionate Benefit Rule for ROR Schemes” on the pamphlet's page 9 does not have a corresponding note defining “accrued benefit under the scheme”.

The Institute would like to know whether “accrued benefit” in relation to ROR schemes, would also exclude investment income attributable to the employer’s contributions.

Mr Chiu told the meeting that the proportionate benefit rule, introduced under the Inland Revenue (Amendment) (No. 5) Ordinance 1993, was an anti-avoidance provision under the then section 8(4) of the IRO. He said that the intention was to combat abuse of tax exemption through entering into a short-term employment contract which provided for disproportionate amount of remuneration paid in the form of employer’s contributions to a scheme registered or exempt from registration under the Occupational Retirement Schemes Ordinance ("ORSO scheme") and withdrawn...
as tax-free benefits at the end of the contract. He further mentioned that the
"proportionate benefit" was defined in the then section 8(4)(b) of the IRO as "the sum
not exceeding the amount bearing the same ratio to the accrued benefit of the
relevant person as represents the employer’s contributions under the scheme as the
number of completed months of service with the employer bears to 120 months”.

Mr Chiu advised that by virtue of the Provident Fund Schemes Legislation
(Amendment) Ordinance 1998, the words “as is attributable to” ("可歸因於")
substituted the words “as represents” ("代表"). They were then consistently used in
sections 8 and 9 of the IRO in relation to MPF schemes and ORSO schemes. He
pointed out that such a change in wording was required since it was not correct to
say that the accrued benefits represented contributions. The words “is attributable
to” referred to the investment of the employer’s contributions, which would include
employer’s contributions (be they mandatory or voluntary) and investment return
arising therefrom.

Mr Chiu stressed that the nature of employer’s voluntary contributions under MPF
schemes was no different from contributions under ORSO schemes which were
made on a voluntary basis and were not subject to the preservation, vesting and
portability requirements. He said that an employee’s entitlement to benefits derived
from employer’s voluntary contributions under MPF schemes was subject to a
vesting scale under the governing rules drawn up by the employer. The
contributions held by a trustee would be subject to forfeiture if the conditions were
not fulfilled, or in the event that the employee resigned or was dismissed due to
misconduct, etc.

Mr Chiu went on to say that at the time when the employer’s voluntary contributions
were paid to the trustee of an MPF scheme, the employee only received a promise
with respect to such contributions. He advised that the employee was only entitled to
claim payment when the investment, which included the employer’s voluntary
contributions and investment gains or losses, was vested in the employee free of all
conditions. For the purpose of calculating the proportionate benefits, he explained
that the accrued benefits were equal to the vested balance of the investment
attributable to employer’s voluntary contributions under the MPF scheme and the
same principle should apply to an ORSO scheme. He concluded that, in computing
the proportionate benefit, the investment return on the voluntary contributions under
an MPF scheme or contributions under an ORSO scheme was not to be excluded.
He disclosed that the IRD would clarify the interpretation and practice when updating
DIPN 23 and the pamphlet mentioned in the Institute’s question.

(e) Taxation of ORSO distributions

DIPN 23 (Revised) states that, "It should be noted that in the case of ROR schemes,
liability arises when the amount is received, unless it is received under circumstances
where exemptions are applicable. Regarding accrued benefits from MPF schemes,
liability can arise when the benefit is taken to have been received."

For example, an individual was covered by an ORSO plan when he was working in Hong Kong, under which his Hong Kong employer ("Co A") made contributions to the plan. The individual was subsequently relocated to another country and employed by another overseas company within the group ("Co B") under a non-Hong Kong employment.

Under the ORSO plan, the individual could choose not to withdraw the vested portion of Co A's contributions when the Hong Kong employment ceases. If the individual chooses not to withdraw the contributions, the contributions would continue to vest and the services with Co B would be counted in determining the vesting benefits (but no further contributions would be made by Co A). In such a case:

(i) would the individual be subject to salaries tax on Co A's contributions at the time he could choose to withdraw (even though there was no actual withdrawal), or at the time the actual withdrawal take place?

Ms Tsui referred to section 11D(b) of the IRO which provided that "income accrues to a person when he becomes entitled to claim payment thereof". She said that taking section 11B together, the assessable income of a person in a year of assessment should be the aggregate amount of his income from employment which he was entitled to claim payment in that year. She further mentioned that pursuant to the proviso to section 11D(a), "income which has either been made available to the person to whom it has accrued or has been dealt with on his behalf or according to his direction shall be deemed to have been received by such person".

Ms Tsui stated that the terms of the ORSO plan in the Institute's example provided the individual with the option to withdraw or not to withdraw the vested benefits attributable to Co A's contributions ("the Sum") from the plan when the Hong Kong employment ceased (i.e. the individual was entitled to claim payment of the Sum at the time when the Hong Kong employment ceased and he could make the choice). She said that if he decided to take the option of not withdrawing the Sum but leaving it to continue to vest under the ORSO plan, then by this decision the Sum would have been dealt with on his behalf or according to his direction. She added that pursuant to the proviso to section 11D(a), the Sum would be deemed to have been received by him and thus subject to salaries tax at the time when the employment with Co A came to an end and he made the choice of not to withdraw.

(ii) what about if there was no further vesting after changing employment to another group entity but the individual could choose not to withdraw the vested benefit from the ORSO plan?
Ms Tsui said that the same tax treatment in part (i) above would apply pursuant to the proviso to section 11D(a) of the IRO. She indicated that the absence of further vesting would not make a difference. She continued, saying that if there was no further vesting after changing employment to another group entity, there would be no reason and it would be unrealistic for the individual to choose not to withdraw the vested benefit from the ORSO plan.
Agenda item A3 - Double tax agreements

(a) Definition of "Recognized stock exchange" under Article 13 of the Hong Kong–Mainland Double Taxation Arrangement ("HK-Mainland DTA")

In respect of the amendment to Article 13 of the HK-Mainland DTA, the first paragraph of Article 3 in the fourth protocol states that:

"Notwithstanding the provisions of paragraphs 4 and 5, gains derived by a resident of One Side from the alienation of shares of a company that is a resident of the Other Side quoted on a recognized stock exchange shall be taxable only in the Side of which the alienator is a resident...."

In this connection, the Institute would like to know whether, in addition to recognized stock exchanges located in mainland China and Hong Kong, would the term "recognized stock exchange (被認可的證券交易所)" also include reputable stock exchanges located in other jurisdictions?

To the question, Ms Mei answered "no" and said the term "recognized stock exchange (被認可的證券交易所)" did not include any stock exchange located in third jurisdictions. She made clear that according to the mutual understanding between the State Administration of Taxation and the IRD, the recognized stock exchanges in the Mainland were Shanghai Stock Exchange and Shenzhen Stock Exchange, whilst that in Hong Kong was the Stock Exchange of Hong Kong.

(b) Eligibility of investment funds under Article 13 of the HK–Mainland DTA

Under the new paragraph 6 ("new paragraph") of Article 13 of the HK-Mainland DTA (Article 3 of the fourth protocol refers), investment funds that would like to take advantage of the new paragraph would need to meet certain conditions such as being recognized by the Securities and Futures Commission of Hong Kong and 85% of the capital being raised via specified channels in Hong Kong. In this connection, the Institute would like to ask:

(i) For investment funds which are incorporated or constituted under Hong Kong laws but do not satisfy all the conditions in the new paragraph, would they still be able to claim the tax benefit by virtue of them being a Hong Kong resident under the general definition, i.e., being incorporated or constituted under Hong Kong laws?

Ms Mei again answered "no" to the question and said such an investment fund would not be able to claim the tax benefit merely by virtue of being incorporated or constituted under Hong Kong laws. She informed that the investment fund had to satisfy all the conditions prescribed in the new paragraph of Article 13 of
the HK-Mainland DTA in order to obtain the relevant tax relief in the Mainland.

(ii) Similarly, for investment funds which are incorporated or constituted under foreign laws but do not satisfy all the conditions in the new paragraph, would they still be able to claim the tax benefit by virtue of them being a Hong Kong resident under the general definition, i.e., they are normally managed or controlled in Hong Kong?

Ms Mei replied in the negative and said such an investment fund would not be able to claim the tax benefit merely by virtue of being normally managed or controlled in Hong Kong. She reiterated that the investment fund had to satisfy all the conditions prescribed in the new paragraph of Article 13 of the HK-Mainland DTA.

(iii) If investment funds that do not satisfy all the conditions of the new paragraph are unable to rely on the general definition of the term “Hong Kong resident” to claim the tax benefit, could this mean that the fourth protocol has tightened the definition of Hong Kong resident for investment funds? On the other hand, where an investment fund meets all the conditions of the new paragraph, would its claim for the tax benefit be less likely to come under challenge in relation to the anti-treaty abuse provision?

Ms Mei told the meeting that the new paragraph 6 of Article 13 of the HK-Mainland DTA served to clarify the tax treatments for investment funds in respect of the gains on sale and purchase of shares in Mainland and Hong Kong listed companies since investment funds, as the IRD understood, were not normally treated as a legal personality in the Mainland.

Ms Mei advised that Article 4 of the Fourth Protocol might be invoked to deny the above tax treatments if it was concluded, having regard to all the relevant facts and circumstances, that the main purpose of the creation or disposition of the shares acquired was to take advantage of those treatments. She reminded that the fact that an investment fund could meet all the qualifying conditions would not prevent the application of such anti-abuse provision by Mainland tax authorities.

(c) Hong Kong certificate of resident status

In agenda item A4(g) of the 2015 annual meeting, the IRD provided some factors that would be considered to determine whether a company's management and control is located in Hong Kong. In our view, this is consistent with paragraph 24 of the OECD Model Tax Convention on Income and on Capital’s Commentary (“Commentary”) on Article 4, which refers to “place of effective management” to determine residency. The IRD added that it would also consider beneficial ownership, which the Institute appreciates as important to Hong Kong's responsibility as a treaty partner.
However, beneficial ownership may not always be interpreted in the same way by different countries. For example, while a beneficial owner of an income must, generally, be the real owner of the income and not be required to pass on the income to another party, the Canadian case of *Prevost Car Inc v. Regina* ruled that an agreement between two shareholders requiring the immediate distribution of dividends received from its subsidiaries did not mean that the immediate holding company were not the beneficial owners of the dividends received.

In addition, the residency requirement to qualify for a DTA benefit is not limited to passive income where beneficial ownership is considered. Beneficial ownership may not always be relevant, for example, in determining a permanent establishment under Article 5. The Institute would like to ask if the IRD would consider having more emphasis on the "place of effective management", rather than "beneficial ownership".

Besides that, in light of the BEPS Action 6, which looks to include the limitation-of-benefit rule and the principal purposes test, the Institute would like to understand how this would affect the Hong Kong treaties, and interact with the application for treaty benefits, including the application for certificate of residency.

Ms Mei replied that a Certificate of Resident Status was a document issued by the IRD to a Hong Kong resident who required proof of resident status for the purposes of claiming tax benefits under DTAs. She pointed out that two matters were involved, “Hong Kong resident” and “tax benefits”.

Ms Mei indicated that the IRD was committed to providing Hong Kong residents with assistance in claiming all the tax benefits to which they were entitled under a DTA. She said that if the IRD had reasons to believe that a person would not be entitled to benefits under a DTA, the IRD might request further information from the person before deciding whether a Certificate of Resident Status could be issued. She stressed that where it was clear that the person would not be entitled to those benefits, the IRD might refuse to issue a Certificate of Resident Status, as it was vitally important that the IRD upheld the terms and purpose of Hong Kong’s DTAs.

Ms Mei explained that “beneficial ownership” was the pre-requisite for granting preferential tax treatment in the passive income articles of a DTA. She indicated that if the person intended to claim benefits under these articles, that person had to demonstrate that all the criteria of the relevant article, including the “beneficial ownership” requirement, had been fulfilled, failing which the Certificate of Residence Status might not be issued.

Ms Mei went on to explain that the interpretation of “beneficial ownership” had been fully elaborated in the Commentary and such an interpretation had received wide acceptance internationally. She indicated that the IRD’s understanding was that the interpretation given to the term under the Commentary had been consistently followed by Hong Kong treaty partners.
Ms Mei pointed out that “treaty shopping” was a problem that all jurisdictions agreed to tackle. She referred to the sample formulation of limitation-of-benefits provisions in the OECD Model Tax Convention and the specific anti-abuse rules in BEPS Action 6 report which were suggested for applying to existing DTAs through a multilateral instrument. She disclosed that the IRD was keeping a close watch on the development.

Mr Lean had concerns about the different interpretation on the provisions of DTAs made by treaty partners and that would inevitably lead to denial of treaty benefits by treaty partners. He said that some countries, like the Mainland, did not follow the OECD guidelines on the interpretation of beneficial owner. He sought clarification on how the IRD interpreted the definitions under the provisions of a DTA. CIR replied that the general guideline was to make reference to the Commentary in the OECD Model Tax Convention and if a Hong Kong resident had been denied treaty benefits by the tax administration of the treaty partner, the Hong Kong resident might initiate the Mutual Agreement Procedure under the relevant DTA.

Mr Lean further asked whether the applicant could pursue his claim through a judicial process if his application for a Certificate of Resident Status had been rejected. Mr Chiu replied in the negative and advised that the IRO did not have any statutory provisions concerning the Certificate of Resident Status. The issue of Certificate of Resident Status was a practice to provide Hong Kong residents with assistance to claim all treaty benefits they were entitled to under a DTA. He stressed that the IRD had to be fair to all applicants and act in good faith in fulfilment of its obligations under DTAs. He said that a Certificate of Resident Status should be issued unless the IRD had good reasons to believe that an applicant would not be entitled to benefits under a DTA. He disclosed that out of 3,000 applications for Certificates of Resident Status in the previous year, less than 10% of applications were rejected.

Mr Anthony Tam pointed out that the Commentary on Article 4 concerning the definition of resident referred to “place of effective management” to determine residency whilst the passive income articles of a DTA, like Article 10, referred to “beneficial ownership” to determine a person’s resident status. Mr Anthony Tam added that there were also other circumstances in which “beneficial ownership” was not a factor when determining residence, e.g., in the context of defining what constituted a “permanent establishment”. He had concern that an inconsistent assessment could arise where the treaty partner considered the “place of effective management” criteria in determining residency while Hong Kong considered the beneficial ownership criteria. CIR responded that it would be unlikely since the tax resident assessment was made on a treaty-by-treaty basis. Mr Chiu supplemented that before issuing a Certificate of Resident Status, the IRD would examine the case and request further information where necessary before determining whether the applicant was a resident of Hong Kong. The IRD would consider whether the applicant had any economic substance in Hong Kong, who was the beneficial owner.
of the income concerned and whether there was any treaty abuse. He indicated that an application for Certificate of Resident Status would be rejected if the applicant was regarded as only a conduit or paper company. He disclosed that during DTA negotiations, Hong Kong’s treaty partners would always require the IRD to explain in detail the application process in order to ensure that Hong Kong had sufficient safeguards to prevent treaty abuse.

On the issue of tax resident assessment, Ms Chan further asked whether, given that the question was considered on a treaty-by-treaty basis, it would be possible for the same applicant to have a Certificate of Resident Status issued under one DTA while being rejected in respect of another DTA. Mr Chiu said that the question was academic, but it would be unlikely in practice.

Mr Anthony Tam went on to comment that the IRD appeared to act far beyond its normal role as a treaty partner since the tax benefit claims arose in another jurisdiction. Mr Chiu responded that the terms of DTAs concluded were part of the tax law in Hong Kong and the IRD’s role was to act in accordance with the law.
Agenda item A4 - Departmental policy and administrative matters

(a) Documentation under BEPS

The Institute would like to ask if the IRD could provide an update on how the BEPS Action Plan would be applied in Hong Kong. In particular, would there be any new documentation requirement similar to Action 13 (e.g., Master file, local documentation and country-by-country reporting)?

Mr Tam Tai-pang (“Mr Tam”) said that in October 2015, the OECD issued its final reports on the 15 BEPS actions. He said that the OECD was prepared to establish an inclusive framework with all interested jurisdictions to develop standards and guidance for implementing the BEPS measures, one of which being transfer pricing documentation. He advised that as indicated by the Financial Secretary in the 2016-17 Budget Speech, Hong Kong was obliged to implement the BEPS measures and the Government would conduct analysis, consult the stakeholders and consider participating in the inclusive framework.

Regarding the new documentation requirement under BEPS Action 13, Mr Anthony Tam commented that not many Hong Kong multinational enterprises would be affected due to high threshold on the income level. He also pointed out that some countries would require large multinational enterprises to file country-by-country reports, including the master file and the local file, starting from 2017. He asked whether the IRD would issue a DIPN on the new documentation requirement or whether the IRD would consider incorporating the new documentation requirement into the IRO. CIR responded that the standardized country-by-country reporting was one of the minimum standards. He took the view that a DIPN would not be sufficient and specific provisions in the IRO might be needed for giving effect to the recommendations contained in BEPS Action 13. In response to Ms Chan’s enquiry, Mr Chiu said that the legislative timetable was yet to be fixed. He envisaged that the Government would consider consulting the stakeholders later because the priorities had been given to the legislative exercises for automatic exchange of information and aircraft leasing.

(b) Exchange of information ("EoI")

The Institute supports Hong Kong entering into more Comprehensive Avoidance of Double Taxation Agreements to avoid double taxation, grant lower withholding taxes on a reciprocal basis, provide tax certainties for cross-border economic activities and allow tax authorities of two contracting parties to exchange information to prevent avoidance or evasion of tax. We also appreciate that the IRD as the competent authority has the obligations to exchange tax information with its treaty partners.
The Institute notes that currently, the IRD will issue the enquiry letter on EoI matters directly to the taxpayer, without copying their tax representatives. As many taxpayers would presume that the IRD has copied all tax correspondence to their tax representatives, including on EoI matters, the deadline for requesting a copy of the information exchanged may have lapsed by the time it comes to the attention of the tax representatives. In order to facilitate the taxpayer in the process for requesting such information, the Institute would like to ask if the IRD could consider copying the enquiry letter on EoI, to the tax representatives.

Mr Tam emphasized that the IRD accorded utmost importance to the preservation of secrecy of taxpayer information and likewise, the OECD laid great stress on maintaining confidentiality as it was the cornerstone for the success of EoI. He pointed out that given its significance in the EoI regime, considerable elaboration on confidentiality had been made in the Commentary. He cited an example in which it was explicitly stated in the Commentary that the requested Party could disclose the minimum information contained in a competent authority letter necessary for it to obtain the requested information. He reiterated that Hong Kong, as a responsible and respectable EoI partner, had to follow the confidentiality rules, which were in line with the secrecy provisions embedded in the IRO and the policy sternly upheld by the IRD.

Mr Tam said that it was not uncommon in practice for a taxpayer to engage different representatives in different dealings with the IRD, for profits tax matters, appeal, investigation, etc. He explained that if a representative was properly authorized for a particular purpose, the IRD would only communicate with that representative for that particular purpose and information not concerning that particular purpose would not be provided to that representative. He advised that copying the enquiry letter on EoI to a tax representative not authorized for the said purpose not only deviated from the prevailing practice of the IRD in handling other tax matters but also violated the confidentiality rules prescribed by the OECD that were followed by Hong Kong’s treaty partners.

Mr Tam indicated that a taxpayer could readily find out whether a letter was copied to his representative as this was apparent from the letter itself. He said that the taxpayer could also pass the enquiry letter to the appropriate representative for prompt action, if considered necessary.

(c) Advance Ruling publication and timeline

According to the IRD’s Annual Report, 19 and 25 rulings were made in 2014-15 and 2013-14 respectively. However, the last advance ruling case published in the IRD’s website was Case No. 54 issued in October 2013. To provide taxpayers with more references, the Institute would like to suggest increasing the publication of advance ruling cases.
In addition, our members have observed that unlike previous rulings, recent rulings would stipulate a time period, for which the ruling would be applicable. The Institute would like to clarify if there has been a change in the approach.

Ms Lee said that the most recent case published was Case No.57 rather than No. 54. She explained that the Department would only publish rulings which were considered to be of general interest, and where the confidentiality of the applicants could be preserved. Therefore the number of rulings made did not have a direct correlation with the number published.

Ms Lee advised that the period for which a ruling was valid would in general be the period to which the particular arrangement related. Facts and circumstances might change over time. The IRD had emphasized in DIPN 31 that a ruling in respect of an arrangement that was intended to apply to similar arrangements would not be valid for more than 2 years.

(d) Practice for unilateral Advanced Pricing Arrangement ("APA") applications

With reference to paragraph 12 of DIPN 48 which reads:

"...Exceptionally, a unilateral APA can be considered in the following situations:
(i) where the DTA partner in a bilateral APA process, or all the DTA partners in a multilateral process, does not/ do not wish to participate in or continue the process;
(ii) where the Commissioner is unable to reach agreement with the DTA partner(s) (see paragraph 82 below);
(iii) where a non-DTA state is prepared to give a unilateral APA regarding transactions which are integrally linked to the controlled transactions covered by the bilateral or multilateral APA...."

It appears that some taxpayers had been unsuccessful in their application for a unilateral APA, although they fall within the above situations. As such, the Institute would like to clarify if the IRD would, at present, consider applications of a unilateral APA, and what factors would likely be considered when deciding to process and/ or grant such an APA.

Under condition (iii), the Institute would also like to clarify the interpretation of “integrally linked to transactions covered under an existing bilateral APA”?

In circumstances where there are jurisdictions which do not have a DTA with Hong Kong, the Institute would like to ask for the IRD views as to whether it foresees any potential difficulties in processing unilateral APA applications, and whether the automatic EoI, which would likely come into effect in 2018, would impact the applications.
Mr Tam said that some applications for a unilateral APA were not accepted since they did not fall within the situations specified in paragraph 12 of DIPN 48. He said that if the case did not fall within the three categories, the application for a unilateral APA would be rejected. He disclosed that the IRD so far had not received any application falling within situation (i) or (ii) and the cases received only related to situation (iii) concerning transactions integrally linked to the controlled transactions covered by a bilateral or multilateral APA.

Mr Tam went on to say that if the separate transactions carried out by controlled enterprises (probably more than two) were closely linked or connected, then the IRD would be prepared to accept that these transactions were integrally linked to one another. He illustrated with an example: the products were manufactured in the Mainland, traded from or in Hong Kong and distributed in the United States and between the Mainland and Hong Kong there was a bilateral APA while the US was ready to give a unilateral APA.

Mr Tam further advised that in circumstances where a jurisdiction did not have a DTA with Hong Kong but a TIEA, the IRD took the view that a unilateral APA remained possible provided that the application fell within one of the three categories. He highlighted the difficulties that would arise where exchange of information was made impossible in the absence of any DTA or TIEA between Hong Kong and the jurisdiction. He reckoned that at the present moment, it might not be easy to predict whether the implementation of automatic EoI in 2018 would have an impact on the number of APA applications.

(e) Progress of APA program

As the APA program has been launched for almost four years, the Institute would like to ask if the IRD would be able to advise on the progress of the program, such as the number of APAs concluded and the number of application in the pipeline. In addition, given the increasing interest in the APA program, the Institute would like to ask if there would be plans to increase the resources to cater for the interest?

Mr Tam told the meeting that after the launch of the program in 2012, eight APA pre-filing requests were received and two bilateral APAs were concluded. He noted that there was a renewal of interest in the program and a number of enquiries were received in the previous year. He recognized, however, that evaluation of APA proposals and gathering of facts prior to applications would normally take some time. He indicated that the IRD would closely monitor the number of APA applications to assess whether there was a need for increased resources.
**Lodgment of tax returns and filing deadlines for 2015-2016**

The Institute would be interested to know the latest statistics on the filing of tax returns and the filing deadlines for 2015-2016.

Ms Lee referred the meeting to four tables. Table 1 showed that the IRD had issued some 1,000 less returns in the 2014/15 bulk issue exercise and some 18,400 returns had not been filed by the due dates. Table 2 showed the filing position under different accounting codes. Table 3 showed the progressive filing results. She pointed out that the overall performance was very unsatisfactory given that the lodgment rate for “M” code returns by the deadline had dropped to 78% while that for “D” code returns remained at 80%. The progress lodgments were also worse and remained significantly below the lodgment standards. She advised that late filing of tax returns would render their clients liable to penal actions. She urged tax representatives to improve their performance in the coming years. Table 4 was a comparative analysis of compliance with the block extension scheme.

**Bulk Issue of 2015/16 Profits Tax Returns**

Ms Lee said that the 2015/16 Profits Tax Returns for “active” files would be bulk-issued on 1 April 2016. The extended due dates for filing 2015/16 Profits Tax Returns would be:

<table>
<thead>
<tr>
<th>Accounting Date Code</th>
<th>Extended Due Date</th>
<th>Further Extended Due Date if opting for e-filing</th>
</tr>
</thead>
<tbody>
<tr>
<td>“N” code</td>
<td>3 May 2016</td>
<td>17 May 2016</td>
</tr>
<tr>
<td></td>
<td>(no extension)</td>
<td></td>
</tr>
<tr>
<td>“D” code</td>
<td>15 August 2016</td>
<td>29 August 2016</td>
</tr>
<tr>
<td>“M” code</td>
<td>15 November 2016</td>
<td>29 November 2016</td>
</tr>
<tr>
<td>“M” code – current year loss cases</td>
<td>1 February 2017</td>
<td>1 February 2017 (same as paper returns)</td>
</tr>
</tbody>
</table>
PART B – MATTERS RAISED BY THE IRD

Agenda Item B1 – Investigation and Field Audit : Discrepancies Detected by Field Audit

Ms Connie Chan referred the meeting to Appendix B which was compiled to illustrate the specific problem areas detected in corporations with tax audits completed during the year ended 31 December 2015. Comparative figures for the years 2013 and 2014 were included.

Ms Connie Chan reported that Field Audit teams uncovered discrepancies in 411 corporation cases, of which 363 carried clean auditors’ reports. She said that the amount of discrepancies detected in the clean report cases accounted for 94% (2014: 85%) of the total discrepancies detected in the year 2015 and total tax of $544 million was recovered from these cases. Average understatement per clean report case was $9.79 million (2014: $12.61 million) while tax undercharged per clean report case was $1.5 million (2014: $1.6 million).

Ms Connie Chan noted that discrepancies in 2015 resulted mainly from omission of sales, understatement of gross profits and incorrect claims of offshore profits. She said that the discrepancies in the majority of cases were detected after examining the business ledgers and source documents.

Agenda Item B2 – Profits Tax Issues

Font size of supporting documents accompanying Profits Tax Return

Ms Lee referred the meeting to agenda item B2(b) of the 2015 annual meeting in which the IRD appealed to tax practitioners for their assistance and co-operation to observe the guidelines on the preferred format for the supporting documents to be filed with each profits tax return. These specifications could facilitate return processing and imaging. The IRD thanked for the support and co-operation by most practitioners.

Ms Lee, however, pointed out that a few practitioners failed to adopt a reasonable font size in preparing the financial statements and supporting schedules. Their supporting schedules were printed in font size 8 or smaller and were illegible. For the benefits of all parties and the accuracy in the examination and processing of tax returns, she again appealed to tax practitioners for their co-operation to observe those guidelines published on the “Tax Representatives’ Corner” of the IRD website. In particular, using font of at least size 11 in preparing the financial statements and supporting schedules would be very much appreciated.

Mr Anthony Tam responded that the Institute would broadcast the IRD’s view and reminded the Institute’s member to follow this rule. CIR expressed his gratitude.
Agenda Item B3 – Date of Next Annual Meeting

The date would be agreed between the Institute and the IRD in due course.
Appendix A

Lodgement of Corporations and Partnerships Profits Tax Returns

Table 1
Lodgement Comparison from 2012/13 to 2014/15

<table>
<thead>
<tr>
<th></th>
<th>Comparison 2013/14</th>
<th>2013/14</th>
<th>2014/15</th>
<th>2014/15</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Y/A</td>
<td>Y/A</td>
<td>Y/A</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2012/13</td>
<td>2013/14</td>
<td>2014/15</td>
</tr>
<tr>
<td>1. Bulk issue (on 1 / 2 April)</td>
<td>179,000</td>
<td>186,000</td>
<td>185,000</td>
<td>-1%</td>
</tr>
<tr>
<td>2. Cases with a failure to file by due date:-</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>'N' Code</td>
<td>2,100</td>
<td>2,200</td>
<td>2,100</td>
<td>-5%</td>
</tr>
<tr>
<td>'D' Code</td>
<td>5,600</td>
<td>6,000</td>
<td>5,900</td>
<td>-2%</td>
</tr>
<tr>
<td>'M' Code</td>
<td>10,000</td>
<td>10,300</td>
<td>10,400</td>
<td>1%</td>
</tr>
<tr>
<td></td>
<td>17,700</td>
<td>18,500</td>
<td>18,400</td>
<td>-1%</td>
</tr>
<tr>
<td>3. Compound offers issued</td>
<td>7,000</td>
<td>7,100</td>
<td>7,500</td>
<td>6%</td>
</tr>
<tr>
<td>4. Estimated assessments issued</td>
<td>6,800</td>
<td>7,100</td>
<td>7,400</td>
<td>4%</td>
</tr>
</tbody>
</table>

Table 2
2014/15 Detailed Profits Tax Returns Statistics

<table>
<thead>
<tr>
<th></th>
<th>'N'</th>
<th>'D'</th>
<th>'M'</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total returns issued</td>
<td>20,000</td>
<td>62,000</td>
<td>103,000</td>
<td>185,000</td>
</tr>
<tr>
<td>Failure to file on time</td>
<td>2,100</td>
<td>5,900</td>
<td>10,400</td>
<td>18,400</td>
</tr>
<tr>
<td>Compound offers issued</td>
<td>1,700</td>
<td>2,400</td>
<td>3,400</td>
<td>7,500</td>
</tr>
<tr>
<td>Estimated assessments issued</td>
<td>0</td>
<td>2,600</td>
<td>4,800</td>
<td>7,400</td>
</tr>
</tbody>
</table>
Table 3
Represented Profits Tax Returns - Lodgement Patterns

<table>
<thead>
<tr>
<th>Code</th>
<th>Lodgement Standard</th>
<th>2014/15 PTRs</th>
<th>2013/14 PTRs</th>
</tr>
</thead>
<tbody>
<tr>
<td>D - 15 August</td>
<td>100%</td>
<td>80% (1)</td>
<td>80%</td>
</tr>
<tr>
<td>M - 31 August</td>
<td>25%</td>
<td>10%</td>
<td>11%</td>
</tr>
<tr>
<td>M - 30 September</td>
<td>55%</td>
<td>16%</td>
<td>16%</td>
</tr>
<tr>
<td>M - 31 October</td>
<td>80%</td>
<td>31%</td>
<td>34%</td>
</tr>
<tr>
<td>M - 15 November</td>
<td>100%</td>
<td>78% (2)</td>
<td>80%</td>
</tr>
</tbody>
</table>

(1) 30% lodged within a few days around 17 August 2015 (33% lodged within a few days around 15 August 2014 for 2013/14 PTRs)

(2) 30% lodged within a few days around 16 November 2015 (29% lodged within a few days around 17 November 2014 for 2013/14 PTRs)

Table 4
Tax Representatives with Lodgement Rate of less than 78% of 'M' code Returns as at 16 November 2015

1,498 T/Rs have 'M' Code clients. Of these, 700 (47%) firms were below the average performance rate of 78%. An analysis of the firms, based on size, is shown below:-

<table>
<thead>
<tr>
<th>Current Year Performance</th>
<th>Last Year Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of clients per firm</td>
<td>Total No. of firms</td>
</tr>
<tr>
<td>Small size firms (100 or less)</td>
<td>1,372</td>
</tr>
<tr>
<td>Medium size firms (101 - 300)</td>
<td>118</td>
</tr>
<tr>
<td>Large size firms (over 300)</td>
<td>8</td>
</tr>
<tr>
<td>Total</td>
<td>1,498</td>
</tr>
<tr>
<td>Number Discrepancy Amount by Nature</td>
<td>Tax Undercharged by Nature</td>
</tr>
<tr>
<td>-------------------------------------</td>
<td>-----------------------------</td>
</tr>
<tr>
<td>Purchases overstated</td>
<td>13</td>
</tr>
<tr>
<td>Gross profit understated</td>
<td>36</td>
</tr>
<tr>
<td>Expenses over claimed</td>
<td>63</td>
</tr>
<tr>
<td>Technical adjustments</td>
<td>68</td>
</tr>
<tr>
<td>Other</td>
<td>67</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>321*</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Auditor’s Report = Qualified</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales omitted</td>
<td>13</td>
<td>21</td>
<td>7</td>
</tr>
<tr>
<td>Purchases overstated</td>
<td>8</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>Gross profit understated</td>
<td>23</td>
<td>12</td>
<td>9</td>
</tr>
<tr>
<td>Expenses over claimed</td>
<td>17</td>
<td>16</td>
<td>13</td>
</tr>
<tr>
<td>Technical adjustments</td>
<td>26</td>
<td>27</td>
<td>13</td>
</tr>
<tr>
<td>Offshore income / profits disallowed</td>
<td>3</td>
<td>4</td>
<td>1</td>
</tr>
<tr>
<td>Other</td>
<td>28</td>
<td>30</td>
<td>24</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>118*</td>
<td>113*</td>
<td>66*</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Number Discrepancy Amount by Nature</th>
<th>Tax Undercharged by Nature</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auditor’s Report = Qualified</td>
<td>2013</td>
</tr>
<tr>
<td>Sales omitted</td>
<td>3</td>
</tr>
<tr>
<td>Purchases overstated</td>
<td>5</td>
</tr>
<tr>
<td>Gross profit understated</td>
<td>8</td>
</tr>
<tr>
<td>Expenses over claimed</td>
<td>12</td>
</tr>
<tr>
<td>Technical adjustments</td>
<td>18</td>
</tr>
<tr>
<td>Offshore income / profits disallowed</td>
<td>6</td>
</tr>
<tr>
<td>Other</td>
<td>21</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>118*</td>
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</table>

**Total Discrepancy for All Years**

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>$3,107,109,918</td>
<td>$3,644,386,335</td>
<td>$3,554,239,498</td>
<td>$437,941,363</td>
<td>$451,579,567</td>
<td>$544,448,403</td>
</tr>
</tbody>
</table>

**Total Tax Undercharged for All Years**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>$437,941,363</td>
<td>$451,579,567</td>
<td>$544,448,403</td>
<td>$437,941,363</td>
<td>$451,579,567</td>
<td>$544,448,403</td>
</tr>
</tbody>
</table>

**Average Amount PER CASE**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>$12,528,669</td>
<td>$12,610,333</td>
<td>$9,791,293</td>
<td>$1,765,893</td>
<td>$1,562,559</td>
<td>$1,499,858</td>
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</table>

**Total Number of Cases**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>248*</td>
<td>289*</td>
<td>363*</td>
<td>248</td>
<td>289</td>
<td>363</td>
</tr>
</tbody>
</table>

**Average Amount PER CASE**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>$2,493,679</td>
<td>$1,773,976</td>
<td>$2,028,582</td>
<td>$362,037</td>
<td>$195,963</td>
<td>$306,672</td>
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</table>

**Total Discrepancy for All Years**

<table>
<thead>
<tr>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>$850,178,043</td>
<td>$660,427,326</td>
<td>$224,762,950</td>
</tr>
</tbody>
</table>

**Total Tax Undercharged for All Years**

<table>
<thead>
<tr>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>$120,671,657</td>
<td>$104,948,232</td>
<td>$31,476,587</td>
</tr>
</tbody>
</table>

**Average Amount PER CASE**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>$9,885,791</td>
<td>$8,053,992</td>
<td>$4,682,561</td>
<td>$1,403,159</td>
<td>$1,279,856</td>
<td>$1,401,277</td>
</tr>
</tbody>
</table>

**Total Number of Cases**

<table>
<thead>
<tr>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>334</td>
<td>371</td>
<td>411</td>
</tr>
</tbody>
</table>
## Extracts of Analysis in Appendix B

<table>
<thead>
<tr>
<th>Description</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) No. of corporation cases with discrepancies uncovered</td>
<td>371</td>
<td>411</td>
</tr>
<tr>
<td>(b) No. of corporation cases in item (a) carried clean auditor’s reports</td>
<td>289</td>
<td>363</td>
</tr>
<tr>
<td>(c) Total discrepancies detected in all cases</td>
<td>$4,305m</td>
<td>$3,779m</td>
</tr>
<tr>
<td>(d) Total discrepancies detected in clean auditor’s report cases</td>
<td>$3,644m</td>
<td>$3,554m</td>
</tr>
<tr>
<td>(e) Percentage of (d) over (c)</td>
<td>85%</td>
<td>94%</td>
</tr>
<tr>
<td>(f) Total tax uncovered in clean auditor’s report cases</td>
<td>$452m</td>
<td>$544m</td>
</tr>
<tr>
<td>(g) Average understatement per clean auditor’s report case</td>
<td>$12.61m</td>
<td>$9.79m</td>
</tr>
<tr>
<td>(h) Tax undercharged per clean auditor’s report case</td>
<td>$1.56m</td>
<td>$1.5m</td>
</tr>
</tbody>
</table>