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 April 2017.

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.

List of Discussion Items

PART A – MATTERS RAISED BY THE INSTITUTE

A1. Profits Tax Issues

A1(a) Offshore bond funds
A1(b) Profits tax exemption for offshore private equity funds (PE funds)
A1(c) Corporate treasury transaction
A1(d) CTCs: Calculating tax rates for loan interest subject to tax outside HK
A1(e) Change in transfer pricing policy
A1(f) Transfer pricing report as a basis for transfer pricing adjustment
A1(g) Royalty deemed taxable under section 15(1)(ba)
A1(h) Conversion of a legal practice into a limited liability partnership (LLP)
A1(i) Tax treatment for lease under new accounting standard

A2. Salaries Tax Issues

A2(a) Assessing time-appointment claims
A2(b) Requirement of filing employer’s returns

A2(c) Tax credit claim by a partner under personal assessment

A2(d) Definition of accrued benefits

A2(e) Exhaustive list of specified education providers

A3. **Double Tax Agreements**

A3(a) Counting of 183 days under the Employment Income article in the year of change of tax residency

A3(b) Applying the 183-day rule to deferred compensation with vesting period

A3(c) Issuance of HK certificate of resident status (CoR) for part-year HK resident individuals

A3(d) Expanding the double tax agreement network

A4. **Stamp Duty**

A4(a) Statutory declaration form for intra-group relief

A4(b) Associated relationship for intra-group relief

A5. **Departmental Policy and Administrative Matters**

A5(a) E-filing of tax returns

A5(b) Persons authorised to sign a profits tax return

A5(c) Applying the definition of “ordinary resident” under Automatic Exchange of Information (AEOI)

A5(d) Penalty provisions for individual account holders under the AEOI regime

A5(e) First exchanges under AEOI

A5(f) Common Reporting Standard (CRS)

A5(g) Lodgment of tax returns and filing deadlines for 2016/17
PART B – MATTERS RAISED BY THE IRD

B1. Investigation and Field Audit: Discrepancies Detected by Field Audit

B2. Date of Next Annual Meeting
2017
ANNUAL MEETING BETWEEN
THE INLAND REVENUE DEPARTMENT AND
THE HONG KONG INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Full Minutes

The 2016/17 annual meeting between the Hong Kong Institute of Certified Public Accountants and the Inland Revenue Department was held on 21 April 2017 at the Inland Revenue Department.

In Attendance

Hong Kong Institute of Certified Public Accountants (“the Institute”)

Mr Anthony Tam Chair, Taxation Faculty Executive Committee
Mr KK So Deputy Chair, Taxation Faculty Executive Committee
Mr Curtis Ng Deputy Chair, Taxation Faculty Executive Committee
Ms Sarah Chan Member, Taxation Faculty Executive Committee
Mr Edward Lean Member, Taxation Faculty Executive Committee
Ms May Leung 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)
Mr Yim Kwok-cheong 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)
Ms Leung To-shan Senior Assessor (Tax Treaty)
Mr Wong Kuen-fai (“CIR”) welcomed the representatives of the Institute to the meeting and introduced the IRD officers in attendance. He thanked the Institute’s support for the annual meeting through which issues of common interest could be discussed. Mr Anthony Tam thanked CIR for his warm welcome and holding the annual meeting which offered a valuable opportunity to exchange views between the Institute and the IRD. He expressed the Institute’s appreciation for the support given or to be given by the IRD in the Institute’s tax-related events in the past year and the coming months. CIR thanked Mr Anthony Tam for his kind remarks. The meeting then proceeded to discussion of the agenda items raised by both sides.

PART A - MATTERS RAISED BY THE INSTITUTE

Agenda item A1 - Profits tax issues

(a) Offshore bond funds

In paragraph 24 of the Departmental Interpretation and Practice Notes (DIPN) No. 43 (Revised) issued in May 2016, the IRD states that “the holding of debentures, loan stocks, bonds or notes to earn “interest income” is not a transaction in securities since such holding does not involve two transacting parties and cannot be regarded as a transaction. The interest derived therefrom could only be considered as derived from incidental transactions and not specified transactions.”

The above interpretation may subject many bond funds to Hong Kong (HK) profits tax. This is because bond funds would primarily invest in bonds, where interest income could be the principal source of income for any one year, and would likely exceed the 5% threshold.

In view of the growing popularity of bond funds, would the IRD consider adopting a more liberal interpretation of the relevant provision? For example, the interest income could be viewed as being derived from the purchase of the bonds which involved two transacting parties, i.e., the seller and the bond fund concerned.

In addition, we would ask the IRD to consider the possibility of expanding the list of specified transactions contained in Schedule 16 to the Inland Revenue Ordinance (IRO) to cater for the needs of the bond funds, so as to enhance the attractiveness of the offshore fund exemption regime.

Mr Yim said that, when answering the question in agenda item A1(g)(i) of the 2007 annual meeting, the IRD explained that interest on securities was derived from holding the securities rather than from a transaction in securities and interest could only be considered as derived from incidental transactions and not specified transactions. He pointed out that the IRD’s interpretation, which followed the legislative intent, had not changed since then. He advised that the elaboration in paragraph 37 of DIPN 43 (Revised) was not new and could be found in the previous version of the same DIPN. He explained that while it might...
be difficult to provide a definition of "incidental transactions" that could cover all possible modes of operation adopted by different offshore funds, the word "incidental" should be accorded its common meaning, providing the desired flexibility to different offshore funds. He further explained that the buying and selling of a bond was generally a specified transaction falling within section 20AC(1)(a) while the payment and receipt of interest from such a bond was an incidental transaction falling within section 20AC(1)(b). He concluded that the IRD did not find it appropriate to deviate from its current interpretation of the relevant legislative provisions.

Mr. Yim informed the Institute that there was no current plan to expand the list of specified transactions in Schedule 16 to the IRO. He said that any amendment to Schedule 16 required a policy decision. CIR supplemented that even though the Commissioner was empowered to amend Schedule 16, any changes would require justifications and policy support.

Given the growth of bond funds in recent years, Mr Anthony Tam expressed concern about the IRD’s current interpretation of the relevant legislative provisions which might be a disincentive for the development of fund management in HK. He pointed out that the Institute raised the same question in 2007 and things were changing over the past ten years. He enquired whether the IRD would consider the possibility of amending Schedule 16 to the IRO to cover interest income derived from bond funds so as to address the calls from the fund management industry.

In response, CIR reiterated that the IRD’s current interpretation of "specified transactions" and “incidental transactions” remained unchanged. He advised that expanding the list of specified transactions in Schedule 16 was a change of policy and would require in-depth policy consideration.

(b) Profits tax exemption for offshore private equity funds (PE funds)

According to section 20AC(3), the exemption status of an offshore fund in a particular year of assessment will be tainted only by its involvement in any non-specified transactions in that year of assessment. At the same time, paragraph 54 of DIPN 51 further explains "Where an offshore private equity fund carries on any other business in HK other than the specified transactions and transactions incidental to the carrying out of specified transactions, it will lose its tax exemption status because of the provision in section 20AC(3). For example, an offshore private equity fund invests in a number of overseas private companies, one of which is carrying on business or holding an immovable property in HK (i.e. only one overseas private company fails to quality as an excepted private company). Transacting in the securities of that overseas private company will taint the investments in other overseas private companies. Clearly, the offshore private equity fund is not eligible for profits tax exemption under section 20AC." (emphasis added)
Since paragraph 54 is under the heading of "Interposed SPV", there is uncertainty that this paragraph may be interpreted to mean that any transactions in an overseas private company that is not an excepted private company (EPC) by a special purpose vehicle (SPV) of an offshore fund will taint the exemption of other SPVs owned by the same fund under section 20ACA, or taint the exemption status of the fund under section 20AC. If this is the position taken by the IRD, this will create a lot of concern for the fund industry and reduce significantly the attractiveness of the offshore PE funds exemption regime.

In this regard, the Institute likes to clarify the interpretation of paragraph 54 of DIPN 51.

CIR explained that by reason of section 20AC(3) of the IRO, the tax exemption provision for an offshore fund would not apply if it carried on any trade, profession or business in HK involving any transaction other than specified transactions. He pointed out that as explained in paragraph 54 of DIPN 51, an offshore fund would not be tax exempted if it invested in an overseas private company which failed to qualify as an EPC, whether held directly or indirectly through an SPV. He considered it should be clear that a transaction in an overseas private company, directly or indirectly held, which was not an EPC, would taint the exemption status of the PE fund under section 20AC and as a result the SPVs would not be tax exempted under section 20ACA.

CIR had taken note of the concern of the Institute members but expressed that the IRD’s duty was to administer the law as it was and not what it wished to be. Mr Chiu added that the IRD’s position on the tainting provisions under section 20AC(3) was not new and could be found in DIPN 43 back to 2006 when the offshore fund exemption regime was enacted.

Mr So expressed the view that the fund industry found the tainting provisions onerous and would adversely affect the attractiveness of the offshore PE fund regime. He cited the example of Singapore which had introduced a range of incentives to encourage funds to be managed from or domiciled in Singapore and adopted reasonable approach to assess income from designated investments and non-designated investments. Given the more favourable fund regime in Singapore, he worried that some industry players might relocate from HK to Singapore, leading to a negative spill-over impact on other financial services in HK. He commented that it would be fair if the offshore PE funds carrying on both specified transactions and non-specified transactions would be subject to profits tax only on the latter to the extent that income derived from non-specified transactions were arising or derived from HK. He recommended that a quarantine or safe harbour should be adopted to allow greater flexibility in the investment scope. Mr Anthony Tam echoed that the relaxation of the tainting rule was necessary to promote HK as an asset management centre and asked whether the tainting rule was applied on a year by year basis.
Mr Chiu replied that the tainting rule should be applied yearly. He had taken note of the industry’s concern and said that a new piece of legislation relating to profits tax exemption for the resident funds in the form of open-ended fund companies would be introduced to the Legislative Council shortly. He disclosed that such amendment bill sought to allow a safe harbour for investing in non-permissible asset classes so as to address the industry’s concern.

Mr So asked whether the safe harbour would be extended to offshore PE funds in other forms. Mr Chiu responded that the safe harbour would be restricted to resident funds in the form of open-ended fund companies only.

(c) Corporate treasury transaction

“Corporate treasury transaction” is defined in Schedule 17B to mean “any of the following transactions that is entered into by the corporation on its own account and related to the business of an associated corporation— … (b) a transaction investing the funds of the corporation or the associated corporation in any of the following financial instruments for managing the cash and liquidity position of the corporation or the associated corporation— (i) deposits; (ii) certificates of deposit; (iii) bonds; (iv) notes; (v) debentures; (vi) money-market funds; (vii) other financial instruments (except securities issued by a private company as defined by section 20ACA(2)); …”

To determine whether a company that has undertaken the transaction is a qualifying corporate treasury centre (CTC) or not, the Institute would like to clarify whether a transaction that involves a qualifying CTC obtaining funds from its overseas associated corporations and investing the same in long-term financial instruments (say, held for several years) would qualify as a corporate treasury transaction? Given the long-term nature of the investment, could the investment of the funds by the CTC be regarded as being made for the purposes of the cash and liquidity management of the CTC or the associated corporations concerned?

Mr Chiu explained that if a CTC obtained funds from its non-HK associated corporations and invested the same in the money-market financial instruments in section 2(1)(b)(i) to (vii) of Schedule 17B, such a transaction would fall within the definition of “corporate treasury transaction” so long as the investment was for the purpose of managing the cash and liquidity position of either the CTC itself or the non-HK associated corporations concerned. He pointed out that the money-market financial instruments were not restricted to those held for a short period of time. He remarked that investing funds in long-term money-market financial instruments by the CTC for managing the cash and liquidity position of its non-HK associated corporations should not be excluded.
CTCs: Calculating tax rates for loan interest subject to tax outside HK

Section 16(2)(g) states that, “the borrower is a corporation carrying on in HK an intra-group financing business and-

(i) the deduction claimed is in respect of interest payable by it on money borrowed from a non-HK associated corporation (lender) in the ordinary course of that business;

(ii) the lender is, in respect of the interest, subject to a similar tax in a territory outside HK at a rate that is not lower than the reference rate; and

(iii) the lender’s right to use and enjoy that interest is not constrained by a contractual or legal obligation to pass that interest to any other person, unless the obligation arises as a result of a transaction between the lender and a person other than the borrower dealing with each other at arm’s length.”

(emphasis added)

Besides that, paragraph 20 of DIPN 52, states, “Generally, the rate in section 16(2)(g)(ii) shall be determined in accordance with the income tax principles of the jurisdiction in which the lender is tax resident. If the interest is attributed to a permanent establishment of the lender located outside its jurisdiction of residence, a holistic analysis is required. Reference shall be made to the income tax principles of the jurisdiction in which the lender is resident and of the jurisdiction in which the permanent establishment is located.” (emphasis added)

Take for example, in the ordinary course of its intra-group financing business carried on in HK, a HK company borrowed a loan from a branch in jurisdiction F2, established by company F1 (a non-HK associated corporation resident in jurisdiction F1). Under the terms of the loan, the HK company paid the loan interest to the branch of company F1.

Jurisdiction F1 adopted a worldwide corporation tax system under which profits from residents’ foreign branches would be taxed. In the taxable year in which the interest was earned, company F1 was required to pay corporation tax in both jurisdiction F1 (tax rate at 25%) and jurisdiction F2 (tax rate at 10%). There was no double tax arrangement between jurisdictions F1 and F2.
The Institute would like to ask:

(i) Which rate will be used for comparison with the HK reference rate (16.5%) for the purpose of section 16(2)(g)(ii)?

Mr Chiu said that where the loan involved a permanent establishment in a third jurisdiction, the IRD would adopt a holistic approach to decide the rate at which the interest income is taxed. He explained that Jurisdiction F1 was generally expected to provide unilateral tax relief, whether by way of exemption or unilateral tax credit, in respect of the interest accrued to the permanent establishment; and if that was the case, the tax rate of 25% would be used for comparison with the HK reference rate. He stressed that, however, even in the absence of any unilateral tax relief, the answer should remain the same since the legislative provision referred to the rate in a territory at which tax was paid by the lender and not the aggregate of rates in different territories.

(ii) Would the “subject to tax” condition be considered as satisfied?

Mr Chiu responded that since the rate of 25% was higher than the reference rate of 16.5%, the “subject to tax” condition would be regarded as having been satisfied. He confirmed that this would still apply if the respective tax rates in Jurisdictions F1 and F2 were reversed.

In response to a further question from Mr Anthony Tam and Mr Lean, Mr Chiu confirmed that the tax rate in Jurisdiction F1 before setting off the tax credit and granting tax exemption would be adopted.
(e) Change in transfer pricing policy

The Institute understands that substantive support should be provided to the IRD when there is a change in transfer pricing policies of a taxpayer. Generally, an actual restructuring of the taxpayer’s operations (i.e. change in actual function and risk profile) could justify a change in transfer pricing policy.

Recently, many taxpayers have taken opportunity of the Base Erosion and Profit Shifting (BEPS) initiatives, to revisit their transfer pricing policies and update their policies to better align the transfer pricing outcomes with value creation activities, based on existing functional and risk profiles. Take a scenario where the review suggests that a HK taxpayer has been over-compensated in the past and the taxpayer changes its transfer pricing policies accordingly. Given the new BEPS environment, would such a review that is supported by proper benchmarking, be sufficient to justify the change, even if it significantly decreases profitability without major changes to the functional and risk profile?

Mr Tam responded that the Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines (July 2010 version) and the BEPS Actions 8 to 10 Final Reports attached great importance to the facts and circumstances of each case when determining the appropriate pricing for controlled transactions. He pointed out that they both demanded an examination of functions performed, assets used and risk assumed by associated enterprises. In short, the BEPS Actions 8 to 10 Final Reports clarified and strengthened the arm’s length principle to ensure the alignment of transfer pricing outcomes with value creation activities. They should not be quoted as the rationale by enterprises to revise or alter their transfer pricing policies in the absence of changes to their function/asset/risk profiles, unless it could be demonstrated that the Action Plans rendered the original transfer pricing justifications in need of being re-analyzed, and, as result, warranted a revision or alteration of the transfer pricing policies. He said that practically speaking, a back year assessment would not be re-opened unless the provisions in section 70A apply or the terms of a double tax agreement required a corresponding adjustment.

Mr Tam emphasised that the IRD would remain vigilant if profits were dropped out without taxation in any tax jurisdiction as a result of an amendment to the existing transfer pricing policy. He said that, where appropriate, the general anti-avoidance provisions would be invoked to combat profits diversion through mispricing arrangement which was carried out for the sole or dominant purpose of obtaining tax benefits.

Mr Lean pointed out that some transfer pricing specialists considered BEPS Actions 8 to 10 Final Report changed the arm’s length principle for transactions involving intangibles and applied different factors in determining the ownership of intangibles for transfer pricing purposes. He asked whether it was justified for a taxpayer to revise his transfer pricing policies so as to follow the new principles if the
circumstances of the taxpayer’s case were exactly the same as previous years. He took the view that the profits might be slightly different as a result of a change in the existing transfer pricing policies.

CIR responded that the BEPS Actions 8 to 10 Final Reports had not changed the arm’s length principle. Instead the Reports explained the arm’s length principle in greater detail. Mr Chiu gave his observation that some jurisdictions had taken the position the Reports merely clarified the arm’s length principle while others took the view that any modification should not affect back years. He said that HK would implement the updated OECD transfer pricing guidelines in future and roll backs might not be appropriate where there would be double non-taxation.

Mr Anthony Tam mentioned that Bulletin 6, recently issued by the Mainland’s State Administration of Taxation, in addition to the DEMPE (i.e. development, enhancement, maintenance, protection and exploitation) functions in the OECD transfer pricing guidelines added “promotion” as an additional function (i.e. DEMPEP functions). He asked how the IRD addressed the Mainland’s approach which diverged from the latest international transfer pricing standards and included location specific factors. He also raised concern that HK might suffer in a triangular case, for example the Mainland, HK and Japan.

CIR noted the issue and indicated that the IRD would generally adopt OECD approach and follow the relevant provisions under double taxation agreements. Mr Chiu added that multilateral advance pricing arrangement could be an option to resolve the issue. He drew Mr Anthony Tam’s attention to a report titled OECD-Secretary General Report to the G20 Finance Ministers issued in March 2017, which covered the practical tools for enhancing tax certainty.

(f) Transfer pricing report as a basis for transfer pricing adjustment

Transfer pricing is an important issue in both cross-border and domestic related party transactions, especially in the future implementation of the transfer pricing regime proposed by the government. For example, in agenda item B2 of the 2014 annual meeting, the IRD indicated that the service fees received by HK fund managers or advisers would be challenged if such fees were not on an arm’s length basis, taking into account the functions, assets and risks attributed to the HK operations.

In some cases, proper transfer pricing reports prepared by a professional firm have not been accepted by the assessor who, on the other hand, has not suggested any reasonable alternative for the proper pricing in settling the issue.

In this regard, the Institute would like to seek the IRD’s views on:
when and to what extent the IRD would consider it may be necessary to adjust pricing determined in accordance with a properly prepared transfer pricing report produced by a professional firm or an transfer pricing expert;

It was observed that the IRD followed the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2010 (OECD TP Guidelines). In addition, the Final Report on Aligning Transfer Pricing Outcomes with Value Creation (Actions 8-10) under the OECD’s BEPS was also relevant. Both the OECD TP Guidelines and the BEPS Action Plans 8-10 referred to the “Arm’s Length Principle”. The authoritative statement of the Arm’s Length Principle was found in Paragraph 1 of Article 9 of the OECD Model Tax Convention. Under the Arm’s Length Principle, members of a multinational enterprise (MNE) group were treated as operating as separate entities rather than as inseparable parts of a single unified business. Because the separate entity approach treated the members of an MNE group as if they were independent entities, attention should be focused on the nature of the transactions between those members and on whether the conditions in this regard differed from the conditions that would be obtained in comparable uncontrolled transactions.

Ms Connie Chan said that the Assessor would expect any transfer pricing report prepared by a taxpayer or his/her advisers to address the functions, assets and risks of the taxpayer (the tested party), compared with those belonging to other parts of the business and the MNE group. She also said that the report should provide a full account of what the taxpayer did, how other group companies were involved, the value chain analysis and where the relevant risks lay. She emphasised that the Assessor would carefully examine the supporting documentation and critically assess whether the transfer pricing methods and conclusions were justified having regard to the nature/characteristics of the product/activity being examined, the reasonableness of the underlying assumptions, the degree of comparability that existed between the controlled and uncontrolled transactions and the quality and reliability of the comparable data. The selection of a transfer pricing method and the selection of the tested party in a connected transaction between two related parties would be important in finding the most appropriate method for a particular case.

Ms Connie Chan went on to say that a transfer pricing report might not be accepted if the full facts and circumstances of the case were not provided, or if the information provided was inadequate or misleading, such as where there was insufficient contemporaneous transfer pricing documentation, incomplete information of how each group company contributed to the overall activities of the group, or inappropriate assumptions, functional and comparability analyses, use of internal comparables which were not publicly available for verification, changes in business structures or market circumstances not reflected in the report, etc. If the transfer pricing was
considered to be not in accordance with the Arm’s Length Principle, after the above analysis had been carried out, transfer pricing adjustments would be necessary, even if a transfer pricing report had been produced by a professional firm or a transfer pricing expert.

It was noted from Agenda Item B2 of the 2014 annual meeting that the IRD explained the service fees received by HK fund managers or advisers would be challenged if such fees were not on an arm’s length basis, after taking into account the functions, assets and risks attributed to the HK operations. In the present context, Ms Connie Chan elaborated that the transfer pricing report should address the following matters with supporting evidence:

(a) a full picture of the overall business and the profits made by all relevant group companies;
(b) the nature of services provided by the HK fund manager or adviser and the associated functions, assets and risks;
(c) a functional analysis of all the connected parties, including, in the case where certain functions were sub-contracted to outside, arm’s length parties, the fees being charged by these outside parties and whether there were mark-ups being charged by the connected parties concerned; and if there were mark-ups, the justifications for, and the quantum of, those mark-ups;
(d) the relative weight and importance of the activities of the HK fund manager/adviser and the connected parties in earning the profits for the HK company and the group;
(e) details of the investment portfolio managed in HK, compared with other group companies;
(f) the number of employees of the HK manager/adviser, their remuneration packages and duties, compared to other group companies;
(g) the basis of charging (i.e., direct or allocation key, and if the latter, what key);
(h) the identification and justification of the costs to be charged; and
(i) the way the mark-ups had been derived with reference to comparable data, or the way profits were split.

Ms Connie Chan concluded that the transfer pricing report should list the key aspects for the comparability analysis:
(a) the commercial or financial relations between the fund managers and the associated enterprises and the conditions and economically relevant circumstances attached to those relations, so that the controlled transactions were accurately delineated; and

(b) the conditions and the economically significant circumstances of the controlled transactions, accurately delineated from those between independent parties.

Mr Anthony Tam commented that the internal comparable uncontrolled price and for low value adding services a 5% mark-up could be considered. Mr Ng, Mr Anthony Tam and Mr Lean took the view that detailed transfer pricing guidelines were very important to HK. They asked whether the IRD would issue a DIPN on specific transfer pricing guidelines or whether the IRD would consider incorporating the OECD’s transfer pricing guidelines into the IRO, by, say, codifying as a subsidiary legislation. Mr Anthony Tam suggested that detailed rules should not be included in the primary legislation, as the OECD’s guidelines were revised periodically, and primary legislation was more difficult to amend. Mr Lean suggested that HK might consider adopting the UK approach whereby the legislation referred to the OECD’s transfer pricing guidelines as amended from time to time.

In response, CIR appreciated the Institute’s comments and held the view that the DIPN would not be sufficient and specific provisions in the IRO might be needed to give effect to the OECD’s transfer pricing guidelines. Mr Chiu said that subject to policy decision and views of the Department of Justice, transfer pricing rules would be enacted.

(ii) the IRD’s approach to resolving question of transfer pricing when the IRD does not accept a transfer pricing report prepared by the taxpayer; and

Ms Connie Chan explained that having completed the fact-finding process, the Assessor would inform the taxpayer whether the transfer pricing report was acceptable. She said that in most cases, it would be possible to resolve the issues by agreement. In the exceptional circumstances, the divergence of opinions might fall on the understanding of the contributions made by each group company, underlying assumptions made, the criteria for selecting and screening comparables, the choice of transfer pricing methods, etc. She explained that transfer pricing was not an exact science and it was important to establish and agree on a transfer price based on objective analyses.

Ms Connie Chan went on to say that to avoid protracted argument, it was better for both sides to reach early agreement on all the relevant facts and issues. She indicated that attempting to discuss a settlement when basic facts were not agreed was likely lead to delay. Experience had shown that cases
were likely to be resolved earlier when a collaborative relationship was established between the Assessor and the taxpayer from the outset.

Ms Connie Chan stated that if full and complete information was not forthcoming, the IRD would make use of the exchange of information channel to obtain information from other jurisdictions in facilitating the formulation of basis for negotiation or the issuing of a determination, in case no compromise agreement could be reached.

(iii) in the proposed transfer pricing regime, under what circumstances would the IRD consider that a reasonable excuse existed for the purpose of assessing penalties or additional tax, where a taxpayer agreed to a transfer pricing adjustment arising from a tax audit. For example, what transfer pricing documentation would be considered sufficient by the IRD to show that the taxpayer had discharged its burden of proof in substantiating that pricing was on an arm’s-length basis in the first place.

Ms Connie Chan told the meeting that what was a “reasonable excuse” was a question of fact and depended on the circumstances of each case. It was not possible to lay down any hard and fast rules as to whether a reasonable excuse existed. She mentioned that the term “reasonable excuse” would be given an ordinary construction and would not be given a narrow construction. She further stated that a reasonable excuse included any excuse which would be accepted by a reasonable person to justify the deviation in the pricing or pricing not on an arm’s length basis; in other words, the test was more objective than subjective and each case would be determined based on its own facts. For example, where a transfer pricing report was prepared based on the wrong facts and assumptions, and incomplete disclosure of the functions, assets and risks of the relevant tested party, this would not be considered as a “reasonable excuse”.

Ms Connie Chan continued by saying that the assessment of whether the excuse put forward was reasonable was largely an objective one depending on the particular facts of the case. When assessing whether there was a reasonable excuse, the IRD would: (a) identify the matters said to constitute reasonable excuse; (b) examine whether the excuse was genuine; and (c) assess whether the excuse was reasonable.

Ms Connie Chan encouraged taxpayers to make full and frank disclosure of all material facts about the transactions between them and their related parties, in and outside of HK. She said that what was adequate transfer pricing documentation should be determined having regard to the nature, size and complexity of the business or transaction in question. She also mentioned that guidance on the type of information required and considered useful had been set out in paragraphs 88 and 89 of DIPN No. 46 “Transfer Pricing
Guidelines – Methodologies and Related Issues”. She indicated that if a taxpayer had doubt about or was uncertain of the transfer prices, he/she could apply for an advance pricing agreement. She advised that when there was “reasonable excuse” or the Commissioner or his deputies accepted the taxpayer’s representations, no penalty would be imposed.

Ms Connie Chan added that having committed to implementing the BEPS Package, HK was planning to codify the new transfer pricing documentation requirements. She disclosed that the requirements were structured in three tiers comprising a master file, a local file and a country-by-country report.

Mr Anthony Tam commented that some jurisdictions accepted genuine transfer pricing documentation as a reasonable excuse and imposed no penalty, but charged interest only. He raised concern about the tax uncertainty on the penalty that taxpayers were facing. He asked whether the IRD would accept genuine transfer pricing documentation as a reasonable excuse.

CIR responded that genuine transfer pricing documentation might be regarded as a favourable factor in the assessment of whether the excuse put forward was reasonable. Ms Connie Chan also indicated that for field audit and investigation cases, it was the IRD’s practice to charge interest without imposition of penalty if the adjustment was purely on transfer pricing. Mr Chiu added that reliance on professional advice could constitute a reasonable excuse. He went on to say that what constituted a reasonable excuse depended on the facts of the particular case and factors taken into consideration included: the quality of the transfer pricing report, kinds of information provided and the presence of any evidence to suggest that the adjustment was deliberate.

(g) Royalty deemed taxable under section 15(1)(ba)

In agenda item A1(c) of the 2015 annual meeting, CIR advised that if a sum was received by or accrued to a person for the use of or right to use intellectual property outside HK and a portion of it was tax deductible in ascertaining the assessable profits of a person, the IRD would take the view that the same portion was subject to tax under section 15(1)(ba). The Institute would like to know how this can be applied in practice when the time at which a royalty is paid and the tax should be withheld from it as a result of section 15(1)(ba) may be long before it is determined what proportion of that royalty payment has been incurred in producing assessable profits and is therefore deductible?

Mr Yim responded that pursuant to section 20B(2) of the IRO, the non-resident person who received a royalty was chargeable to tax in the name of the payer in HK. He said that the tax charged should be recoverable from the payer. The payer
should, at the time he paid the royalty, deduct a sufficient sum from the royalty to produce the amount of the tax, and he was indemnified against any person in respect of his deduction of such sum.

Mr Yim indicated that the payer should be able to ascertain the extent to which the royalty would be claimed for deduction in respect of the royalty chargeable to tax under section 15(1)(ba). He went on to say that in discharge of his statutory duty under section 20B(3), the payer was in the best position to determine the sum sufficient for meeting the tax liability under section 15(1)(ba). The provision in section 20B also facilitated the payer’s discharge of statutory duty to withhold the sufficient sum from the royalty.

Mr Yim added that if the royalty was claimed for deduction, the payer should promptly provide the supporting information to the Assessor for an early finalisation of the assessment.

Mr Yim said that if a royalty was paid to the same non-resident person in previous years of assessment, the payer should be able to compute the amount of the royalty deductible under section 16 by reference to the basis adopted in those years.

Mr Lean raised concerns about the practical difficulty arising from a “partial offshore claim” where the Hong Kong payer did not know the amount of royalty payment which would be allowed for deduction until some time later, say 18 months for a new case. He considered that the law required the full amount of tax payable to be withheld. However, the IRD’s interpretation could mean that the payer would be indemnified only to the extent of the tax that the recipient should pay. While past years' payments, where applicable, could serve as a reference, they would not necessarily indicate the correct amount to be withheld in the year in question. Ms Sarah Chan also commented that the timing of notifying chargeability of royalty receipt was not clear. Mr Tisman suggested that the interpretation of the relevant provision of the law needed to be clarified. In response, Mr Chiu suggested that, in new and appropriate cases, tax under section 15(1)(ba) on the whole amount of royalty should be withheld to meet the tax liability while waiting for the refund. He assured the meeting that the IRD would finalise the assessment as soon as practicable.

(h) **Conversion of a legal practice into a limited liability partnership (LLP)**

Part IIAAA of the Legal Practitioners Ordinance (LPO), which deals with LLP, became effective on 1 March 2016. A legal practice can now convert an existing practice (generally a partnership or a sole proprietorship) into an LLP, subject to an application to the Law Society of Hong Kong and satisfaction of certain conditions.

Sections 7AP(1)(a) and (1)(b) of the LPO states that “…..(1) The fact that a partnership becomes, or ceases to be, a limited liability partnership --- (a) does not
cause the partnership (i) to be dissolved; or (ii) to cease continuing in existence as a partnership….and (b) does not affect any of the rights and liabilities (whether actual or contingent) of the partnership, or of any person as a partner, that have been acquired, accrued or incurred before the partnership becomes, or ceases to be, a limited liability partnership…..”

According to section 22(3) of the IRO, "If a change occurs in a partnership …., in such circumstances that one or more of the persons who until that time were engaged in the trade, profession or business continue to be engaged therein, … the tax payable by the person or persons who carry on the trade, profession or business after that time shall, notwithstanding the change be computed …. as if no such change had occurred."

The Institute would like to seek the IRD’s confirmation of the position that a legal practice converting from a general partnership into a LLP, would not constitute discontinuance of a business operation or a transfer of business, and therefore, should not have any HK tax implications.

Mr Yim drew the Institute members’ attention that the operation of section 7AP(1)(a) was subject to any written agreement between the partners to the contrary. He referred to section 7AR which provided that: (a) all relevant laws, except those which are inconsistent, apply in relation to a partnership that is a LLP; and (b) relevant laws means the Partnership Ordinance (Cap. 38) and every other law that applies in relation to a partnership, whether an enactment, or a rule of equity or of common law.

Mr Yim said that by virtue of section 7AR, section 22 of the IRO applied to a LLP same as a general partnership. He concluded that if there was no written agreement between the partners that section 7AP(1)(a) should not apply, the conversion of a legal practice from a general partnership into a LLP would not constitute business cessation or a transfer of business and would not have legal implication under the IRO. Mr Chiu confirmed, therefore, that the Institute’s understanding of the matter was correct.

(i) **Tax treatment for lease under new accounting standard**

Under the existing Hong Kong Accounting Standard (HKAS) 17, lease payments are charged to the lessee’s profit and loss account as an expense. Such lease expenses are generally treated as a deductible expense for tax purposes, as long as the rules in sections 16 and 17 of the IRO are satisfied. Under the new Hong Kong Financial Reporting Standard (HKFRS) 16, depreciation of the leased assets (right-of-use assets) and interest on lease liabilities will be charged to the lessee’s profit and loss account instead.
The Institute would like to seek the IRD’s view on the relevant tax treatment under HKFRS 16. In particular, would the existing tax treatment be adopted (i.e. lease payment deductible), given that the actual lease payment is an outgoing incurred during the period?

Mr Yim referred to *Nice Cheer Investment Ltd v. CIR* (2013) 16 HKCFAR 813 in which Lord Millett NPJ explained:

“It must be borne in mind that the new accountancy standards are directed to the preparation of financial statements and not tax computations, and that the two serve different purposes. Financial statements are prepared in order to give investors, potential investors, financial advisers, and the financial markets generally a true and fair view of the state of affairs of the company and in particular its financial position and profitability. Those who read them are concerned not with the past but with the future, and in particular the future profitability of the company. The Ordinance, however, is directed to the past. The Commissioner is not concerned with the likelihood that the taxpayer will make profits in future but whether it made them in the past.”

Mr Yim explained that HKFRS 16 eliminated the classification of a lease by the lessee as an operating or finance lease. All leases were treated similar to a finance lease under HKAS 17. He further explained that under HKFRS 16, all leases were recorded in the lessee’s statement of financial position by recognizing the present value of the lessee’s obligation to make future lease payments as a liability with an asset being disclosed separately within right-of-use assets or together with property, plant and equipment.

Mr Yim said that in raising an assessment, it might be necessary for Assessors to carefully consider whether payments made by a “lessee” were lease rentals or whether they were, in substance, consideration for the sale of goods purported to be leased. He went on to say that in the latter case, the payments would be outgoings of a capital nature which are not deductible for profits tax purpose although they might qualify for initial and annual allowances.

Mr Yim stated that deductions under profits tax were governed by sections 16 and 17 of the IRO. The implementation of HKFRS 16 had no effect on the operation of sections 16 and 17. He, therefore, concluded that lease payments were deductible insofar as they were in compliance with sections 16 and 17.
**Agenda item A2 - Salaries tax issues**

(a) **Assessing time-appointment claims**

DIPN 10 (Revised) on *Charge to Salaries Tax* states that one of three criteria for the IRD to accept that an employment is a non-HK employment is that the contract of employment should be enforceable outside HK.

However, it is common that non-resident employers still need to observe the relevant laws and regulations in HK, even though the employment contracts are not enforceable under HK law. For example, employers are required to comply with the Employment Ordinance (EO) in HK, they may need to apply for a work visa for an individual working in HK under the Immigration Ordinance and the employees will observe the statutory holidays in HK during their HK assignment, etc.

Practitioners have come across some cases, where the assessors rejected the time-apportionment claims of certain individuals on the basis that they needed to observe certain HK laws and regulations according to their employment contracts (which are enforceable under non-HK law). In this regard, the Institute would like to seek the IRD’s clarification that observing HK law and regulations merely because the employees are working in HK would not be an influential factor in assessing the non-HK employment/time-apportionment claims for such employees.

Ms Tsui said that, as explained in paragraph 6 of DIPN 10 (Revised), in determining where the source of income (i.e. the place where the employment is located), the IRD would take into account all of the relevant facts, with particular emphasis on three factors, namely: (a) where the contract of employment was negotiated and entered into, and is enforceable; (b) where the employer is resident; and (c) where the employee’s remuneration is paid. It could be seen that enforceability of contract related to the first factor.

Ms Tsui further said that where an employee was engaged under a HK employment, compliance with overseas law and regulations by the employer or the employee while the employee performed services overseas did not change the HK employment to a non-HK employment. Conversely, compliance with HK law and regulations alone by an employer or employee would not turn a non-HK employment into a HK employment.

(b) **Requirement of filing employer’s returns**

The IRD’s website states that a “company carrying on a business in HK is obliged to file Forms IR56B for all its employees, irrespective whether the employee rendered services in or outside HK, so long as their total income exceeded the prescribed limit.”
In some cases, a HK company may have an overseas branch and the employees, who are residents in the location of the overseas branch, are employed under either a contract with the HK company or a contract with the overseas branch. The overseas branch does not carry on any business in HK and its employees do not render any services in HK. It may also be highly unlikely that these employees will come to HK to perform services.

In the above situation, since the filing of Forms IR56B for the large number of employees of the overseas branch can create a significant compliance burden for the HK company, the Institute would like to seek the IRD’s advice on whether any exemption from filing the Forms IR56B for such employees of the overseas branch could be granted to the HK company to reduce its burden.

Ms Tsui stated that the above quotation from the IRD’s website reflected the obligation of employers carrying on business in HK. She indicated that the specific example mentioned was not common, even if not a rare occurrence. There were not many HK companies with large number of employees who did not perform any services in HK and are residents overseas. Ms Tsui stressed that in any event it remained the statutory obligation of every employer to report remunerations paid to its employees. She added that it was also the statutory obligation of every employee to file his/her individuals tax return to report the whole of his/her income and the employee was at liberty to make claims (including exemption claims), where appropriate, in his/her individuals tax return.

Mr Lean said that, in practice, he had seen a number of such cases and questioned the rationale for gathering such information from the HK employer. CIR explained that the HK employer might claim deductions for remunerations paid to non-resident employees under profits tax, although such deduction claim would likely be disallowed (unless non-resident employees were clearly performing services to produce the HK employer’s profits chargeable to Hong Kong profits tax). CIR further explained that HK had an obligation to exchange information under the Exchange of Information Article in HK’s double tax agreements and tax information exchange agreements. Information, including details of non-resident employees, might be required to be supplied upon requests received from the competent authority of a treaty partner if such requests have been properly made in accordance with the terms of the relevant double taxation agreement or tax information exchange agreement.

(c) Tax credit claim by a partner under personal assessment

A partnership with two partners is carrying on business in HK. During the relevant year of assessment, the partnership provided services to a client in jurisdiction A. There was a withholding tax on the service fee paid by the client in jurisdiction A to the partnership. The service income received is fully subject to HK profits tax on the basis
that the services were rendered in HK.

Under the double tax treaty between HK and jurisdiction A, the partnership claimed the withholding tax paid in jurisdiction A, as a tax credit in its profits tax computation.

One of the partnership’s partners, Mr. B, then elected for personal assessment and it was advantageous for him to be taxed under personal assessment. Accordingly, the tax credit attributable to Mr. B (e.g. $X, calculated based on his profits/loss sharing ratio to the partnership) would be taken away from the partnership’s profits tax assessment when calculating the profits tax payable.

The Institute would like to ask whether $X could be credited against Mr. B’s tax payable under his personal assessment.

CIR said that section 50 of the IRO provided for the allowance of tax credit in respect of arrangements having effect under section 49. He advised that pursuant to section 50(1), tax payable in respect of an item of income in the territory with the government of which the arrangements were made was to be allowed as a credit against tax payable in respect of that income in HK.

CIR mentioned that in the Definitions Article and the Elimination of Double Taxation Article of HK’s double tax agreements, a partnership was treated as a person by HK. In section 2 of the IRO, “person” was defined to include a partnership. Thus, the “person” for the purpose of the IRO should be the partnership itself and not the partners. He went on to say that pursuant to the proviso to section 50(2), the partnership had to be resident in HK for the relevant year of assessment so as to enjoy the tax credit. He stressed that the tax credit in its entirety belonged to the partnership, i.e. the person entitled to the service fee income. He further pointed out that when a partner of the partnership elected for personal assessment (PA), the portion of the tax credit attributable to that partner’s share of the assessable profits of the partnership would be transferred to his PA to compute his overall tax liability in accordance with the provisions in section 50 of the IRO.

Ms Sarah Chan appreciated that there was normally a time gap between the submissions of profits tax returns and individual tax returns. She mentioned that she had come across a case where a partner in a partnership elected for PA and thus at the outset a profits tax assessment without demanding for profits tax on that partner’s share of profits was issued to the partnership. After some time when it was found by the Individuals Tax Unit that it was not to the partner’s advantage to elect PA, a revised assessment was issued to the partnership to demand payment of tax on that partner’s share of profits. She further said that in case a few partners in the partnership elected PA, notices of revised assessments/demand notes for payment of tax on the relevant partner’s share of profits would be issued under the partnership back and forth for a few times, thereby causing unnecessary inconvenience to the partnership and the partners. She took the view that the assessment procedures could be more efficient should there be better communication mechanism between
the Profits Tax Unit and the Individuals Tax Unit.

In response, CIR explained that PA did not necessarily reduce a partner’s tax liability and in the event that it was not to the partner’s advantage to elect PA, profits tax assessment which was previously issued on PA basis needed to be revised to demand for tax on such partner’s share of profits. He pointed out that it took time to ascertain all sources of incomes of each partner and determine whether the partner would or would not benefit from electing for PA. Nevertheless, CIR would remind officers working in different sections to communicate timely to facilitate the raising of assessments. Ms Tsui supplemented that the Individuals Tax Unit would only have the PA issued to the individual taxpayer after ascertaining all his/her sources of income for the year of assessment. Even so, there might be cases where additional income/profits of the individual were identified or come to sight subsequent to the issue of the PA which then rendered it disadvantageous for him/her to elect PA. She, however, stressed that the repeated issue of revised assessments back and forth for many times due to partners’ changing from being PA advantageous to PA disadvantageous or vice versa should be rare.

(d) Definition of accrued benefits

The definition of “accrued benefit” in section 8(6) provides different meaning for the mandatory provident fund schemes (MPF schemes) and the recognized occupational retirement schemes (ORSO schemes). The Institute would like to confirm whether the clause “investment income from the trust funds is not chargeable to salaries tax” under paragraph 19 of DIPN 23 (Revised) of September 2006 is applicable only to MPF schemes but not ORSO schemes (including any MPF-exempted scheme).

Mr Chiu told the Institute members that the IRD, when answering the question in agenda item 2(d) of the 2016 annual meeting, explained:

(a) the words “attributable to”, which were consistently used in sections 8 and 9 of the IRO in relation to MPF schemes and ORSO schemes, referred to: (i) the investment of the employer’s contributions (be they mandatory or voluntary); and (ii) investment return arising therefrom;

(b) the nature of employer’s voluntary contributions under an MPF scheme was no different from the employer’s contributions under an ORSO scheme;

(c) for the purposes of calculating the proportionate benefits, 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; and
(d) In computing the proportionate benefits, the investment return on the employer’s voluntary contributions under an MPF scheme or contributions under an ORSO scheme was not to be excluded.

He, therefore, concluded that accrued benefits attributable to employer’s/employee’s contributions (mandatory or voluntary) included not just the contributions themselves but also the investment income arising therefrom be it an MPF scheme or an ORSO scheme. He elaborated that the clause “investment income from the trust funds is not chargeable to salaries tax” under paragraph 19 of DIPN 23 (Revised) of September 2006 should be read in the context of accrued benefits attributable to the employee’s contributions. He went on to say that it applied to both MPF schemes and ORSO schemes insofar as the income was derived from the investment of employee’s contributions. He disclosed that to provide clarity, the clause would be replaced by “accrued benefits or sums (including investment income) attributable to the employee’s contributions withdrawn from the trust funds were not chargeable to salaries tax” in the next version of the DIPN 23.

(e) Exhaustive list of specified education providers

Under section 12(1)(e) of the IRO, the amount of the expenses of self-education paid in the year of assessment not exceeding the amount prescribed in subsection (6) can be deducted from assessable income in calculating HK Salaries Tax. Some taxpayers find it difficult to check whether the institutions/courses are covered under the term “prescribed course of education”. In particular, taxpayers have to refer to several different lists for the approved institutions, including Schedule 13 to the IRO, the IRD’s website and GovHK’s website. In this regard, would the IRD consider publishing an exhaustive list of all the specified education providers/qualified courses under which self-education expenses can be deducted for taxpayers’ easy reference? Alternatively, if the qualified institutions/courses can be searched via other channels, would the IRD provide the relevant link(s) on the IRD’s website?

Ms Tsui said that to qualify for deduction, the expenses of self-education (SEE) must be paid for a prescribed course of education. She advised that pursuant to section 12(6)(c), a prescribed course of education meant a course undertaken to gain or maintain qualifications for use in any employment and being: (i) a course of education provided by an education provider; (ii) a training or development course provided by a trade, professional or business association; or (iii) a training or development course accredited or recognised by an institution specified in Schedule 13 to the IRO.

Ms Tsui went on to say that according to section 12(6)(d), education providers of a course of education included universities, university colleges or technical colleges. They also included schools registered or exempted from registration under the EO and institutions approved by CIR for the purposes of section 16C. She added that
Ms Tsui pointed out that the Education Bureau administered the registration or exemption of registration of schools under the EO. Therefore, the IRD was not in a position and had practical difficulties to publish on its website an exhaustive and updated list of education providers and courses qualified for SEE deduction. She told the meeting that the IRD’s website was previously linked to a webpage of GovHK on which SEE information was provided. To facilitate a search for the relevant institutions and prescribed courses, the relevant GovHK webpage had been revamped recently. She said that the links after revamp would enable access to: (i) the relevant webpages of the Education Bureau; (ii) Schedule 13 to the IRO; and (iii) education providers under section 12(6)(d) of the IRO.
**Agenda item A3 - Double tax agreements**

(a) Counting of 183 days under the Employment Income article in the year of change of tax residency

According to the Employment Income article (the article) in HK's comprehensive avoidance of double taxation agreements (CDTAs), one of the conditions for exemption from HK salaries tax for remuneration derived by an individual who is a resident of a treaty jurisdiction in respect of an employment exercised in HK is “the individual is present in HK for a period or periods not exceeding in the aggregate 183 days in any 12-month period commencing or ending in the taxable period of fiscal year concerned”. In this regard, the Institute would like to seek the IRD's views on counting the 183 days in the following example:

A French tax resident individual has a non-HK employment with a French employer and had not worked in HK before 1 April 2015. For the period from 1 April 2015 to 31 December 2015, the individual travelled to HK to perform employment services from time to time. During this period, the individual remained a tax resident of France as his family, permanent home and centre of vital interests remained in France. Starting from 1 January 2016, the individual was seconded by his French employer to work in HK on a long-term assignment and his family moved to HK with him. Assuming for the purpose of the France-HK CDTA, the individual became a HK (instead of a French) tax resident from 1 January 2016, and other conditions for exemption under the article had been fulfilled.

The Institute would like to confirm that, in counting the number of days he was present in HK to determine his eligibility for exemption from HK salaries tax, under the relevant article of the France-HK CDTA for the year of assessment 2015/16, the IRD will follow paragraph 5.1 of the OECD Commentary on Article 15 concerning the Taxation of Income from Employment in counting the days of presence. This means that the calculation will include only the HK days for the period from 1 April to 31 December 2015 (when he was a French tax resident), and exclude the HK days starting from 1 January 2016 (when he became a HK tax resident).

Ms Tsui said that in considering the “present for not exceeding 183 days” exemption condition in the year of change of tax residency, the IRD would follow paragraph 5.1 of the OECD Commentary on Article 15 concerning the Taxation of Income from Employment in counting the days of presence. She stated that any period starting from 1 January 2016 during which the individual was a HK tax resident (and no longer a French tax resident) would not be taken into account in the calculation of days present in HK for determining his exemption from HK salaries tax pursuant to paragraph 2(1) of Article 14 of the France-HK CDTA. She, however, pointed out that any period starting from 1 January 2016 during which that individual was a HK tax resident would be taken into account in the time apportionment of income under section 8(1A) and the counting of the number of days present in HK under section 8(1B) of the IRO.
(b) Applying the 183-day rule to deferred compensation with vesting period

The Institute would also like to seek the IRD’s view on how to apply the 183-day rule to deferred compensation (e.g. stock options or stock awards), which may have a multiple-year vesting period.

For example, a Mainland tax resident was granted share options with a 3-year vesting period on 31 March 2012 and he exercised the options on 31 March 2016. It is assumed that his remuneration was paid by a Mainland employer and was not borne by any permanent establishment of the employer in HK. In considering whether the stock option gains are exempt from HK salaries tax under the Mainland-HK CDTA, would the IRD apply the 183-day rule in respect of:

(i) year of assessment 2015/16 only (i.e. year of exercise); or

(ii) each year of assessment from 2011/12 to 2015/16 (i.e. from year of grant to year of exercise); or

(iii) each year of assessment from 2011/12 to 2014/15 (i.e. from year of grant to year of vesting)?

For (iii), i.e. each of years of assessment 2011/12 to 2014/15, would the IRD agree to apply the rule according to the OECD Commentary on the Employment Income article (e.g. paragraphs 2.2, 12.1, 12.3, 12.6 to 12.14)?

Would the answer be different for:

(i) share awards with a vesting period;

(ii) performance bonus without any vesting period but with an earning/performance period (e.g. bonus paid in March 2017 and attributable to service/performance period for calendar year 2016)?

Mr Chiu stated that the Mainland-HK CDTA allowed the allocation of taxing rights between the two Sides. He explained that if a right to tax had been allocated to HK, the provisions in the IRO would be applied to decide when and how to assess deferred compensation (e.g. stock options or stock awards) with a multiple-year vesting period.

Mr Chiu further explained that in counting the days under paragraph 2(1) of Article 14 of the HK-Mainland CDTA for determining taxing right if the employment was exercised in HK by a Mainland tax resident, the relevant rules according to the OECD Commentary on Article 15 concerning the Taxation of Income from Employment would generally be followed.
Mr Chiu pointed out that following the relevant OECD Commentary, Article 14 of Mainland-HK CDTA allowed HK to tax the part of the stock option benefit that constituted remuneration derived from employment exercised in HK and did not impose any restriction as to when the relevant income might be taxed by HK. He said that employee stock options were primarily related to future services. He advised that the stock option gain should not be considered relating to any services rendered after the vesting period.

Mr Chiu mentioned that in determining whether HK has the taxing right, the IRD would apply the 183-day rule for any 12-month period commencing or ending in that year of assessment.

Mr Chiu stated that the share option was granted to the Mainland tax resident on 31 March 2012 with a 3-year vesting period and exercised on 31 March 2016 under a non-HK employment. He explained that since the share option gain accrued in the year of assessment 2015/16 (i.e. the year of assessment in which the option was exercised), the 183-day rule would apply to the year of assessment 2015/16 in accordance of the current practice. The share option gain would then be apportioned by reference to the number of days in HK during the vesting period. He indicated that in the generality of cases, such an approach should comply with the relevant IRO provisions and achieve the intended results as explained in the OECD Commentary on the Employment Income Article.

Mr Chiu went on to explain that share awards were perquisites accruing to an employee in the year of assessment in which vesting took place. He said that the IRD would apply the 183-day rule to the year of assessment in which vesting took place for determining whether HK has the taxing right. He stated that the IRD then would apply the provisions in section 8(1A) and (1B) to compute the salaries tax liability of the Mainland tax resident. As regards performance bonus, he indicated that the IRD would apply 183-day rule to the year of assessment in which the performance bonus accrued for determining whether HK has the taxing right. He said that the IRD, again, would apply the provisions in section 8(1A) and (1B) to compute the salaries tax liability of the Mainland tax resident. He continued that, in the generality of cases, the share awards or performance bonus would be time apportioned by reference to the number of days in HK during the year of assessment in which the income accrued. He took the view that where the facts of the case warranted it, the IRD would consider to exclude: (a) a portion of the share awards referable to the vesting period prior to transfer of an employee to HK under an in-bound employment; or (b) a portion of the bonus clearly attributable to the rendering of services outside HK in a year other than the year of accrual, and reflecting the legal effect of the contractual terms of the employment and the employer’s practice of making performance bonus.

Mr Anthony Tam asked what the position would be if the share options were attributable to directors’ office. Mr Chiu replied that, if the location of the office were in HK, there would be no need to rely on the 183-day rule. Mr Anthony Tam noted
that the central management and control of a company could change from time to time. Mr Chiu said that, whilst it was an unlikely scenario, it should be noted that the taxing right to directors’ fees was given exclusively to the resident jurisdiction under the Article on Directors’ Fees and apportionment might be considered if the central management and control of the company did change during the year.

(c) Issuance of HK certificate of resident status (CoR) for part-year HK resident individuals

(i) According to the Resident article in HK CDTAs, a HK resident individual means:

(1) an individual who ordinarily resides in HK; or
(2) an individual who stays in HK for more than 180 days during the relevant year of assessment or for more than 300 days in two consecutive years of assessment (one of which is the relevant year of assessment).

Practitioners have recently come across some cases where an individual’s application for a HK CoR was denied merely because he could not satisfy the second criterion above (i.e., the 180/300-day test) even though he had strong family and economic ties to HK (therefore, potentially meeting the first criterion of ordinarily residing in HK). In this regard, the Institute would like to seek the IRD’s view on whether it considers that an individual who fails the 180/300-day test could still be a HK tax resident by meeting the “ordinary resident” test under a CDTA.

Ms Mei said that the criteria for determining whether an individual was regarded as a HK resident were specified in the CDTA concluded by HK. She further said that the criteria mentioned in the question (i.e. the ordinary resident test and the 180/300-day test) were generally adopted with slight variations in a few CDTAs as a result of bilateral negotiations.

Ms Mei explained that an individual could be regarded as a HK resident if either criterion was satisfied, meaning that an individual who failed to meet the 180/300-day test could still be a HK resident if the “ordinary resident” test under a CDTA was met.

Ms Mei pointed out that generally, in declining an individual’s application for a HK CoR, apart from informing the applicant that he had failed to meet the 180/300-day test, reasons explaining why he could not be regarded as an ordinary resident of HK were also provided. She, however, advised that the applicant could lodge a fresh application at a later stage when the 180/300 day test was met.
(ii) An individual who ordinarily resides in HK up to 31 March 2017, will emigrate overseas on 1 April 2017.

The Institute would like to know whether the IRD would issue a CoR for the calendar year 2017 to the individual by reason of the fact that the individual ordinarily resides in HK up to 31 March 2017.

Ms Mei reckoned that whether an individual ordinarily resided in HK was a question of fact. She said that the IRD would make reference to case law and considered a number of factors (e.g. whether the individual habitually and normally resided in HK with some degree of continuity, the nature, duration and reasons of his absence from HK, where his family members live, his social and economic ties etc).

Ms Mei further said that if an individual were to emigrate overseas on 1 April 2017, his place of residence would likely change from HK to the other jurisdiction. In this connection, she took the view that the individual could not be regarded as an ordinary resident in HK in 2017 because he would not habitually and normally reside in HK during the period from 1 April to 31 December 2017.

Ms Mei said that the individual ordinarily resided in HK up to 31 March 2017; and he could be regarded as a HK resident if the 300-day test was met (i.e. he stayed in HK for more than 300 days in the years of assessment 2016/17 and 2017/18). She drew the Institute members' attention to the fact that HK's treaty partners took the position that any entitlement to treaty benefits would require the individual to have the necessary personal and economic relations with HK.

(d) Expanding the double tax agreement network

The IRD had a period of rapid expansion in the number of CDTAs a few years back, which has somewhat slowed down in recent times. In the light of HK joining the inclusive framework for implementing the BEPS initiatives and the plans to introduce the four minimum standards under BEPS, what are the IRD’s plans for continuing to expand the CDTA network to other key markets such as the United States, Australia, Singapore, etc?

CIR told the meeting that building a wide CDTA network was conducive to HK’s long term economic development and would enhance our role as an international trading and financial centre. He said that HK had been actively seeking to conclude CDTAs with our major trading and investment partners. He informed the meeting that up to 31 March 2017, HK had signed CDTAs with 37 jurisdictions, which covered 12 out of HK’s top 20 trading partners. He disclosed that the IRD was striving to further
expand HK’s CDTA network. The IRD was currently conducting CDTA negotiations with more than 10 jurisdictions. He advised that the conclusion of a CDTA would very much depend on the treaty policy of our negotiation partner as it took two to tango. He indicated that the IRD would give priority to our major trading partners as well as those countries with potential for economic development, e.g. economies within the “Belt and Road” initiative. He further said that the IRD at the same time would take into account suggestions from the industry.
Agenda item A4 – Stamp duty

(a) Statutory declaration form for intra-group relief

When applying for intra-group relief under section 45 of the Stamp Duty Ordinance (SDO), applicants are required to furnish a statutory declaration. The IRD has provided various templates that are applicable to different scenarios. In these templates, an applicant is required to declare that:

At the date of the said Assignment/Agreement for sale and purchase/Instrument of Transfer/sale and purchase of the HK stock, it was intended on the part of the Transferee Company to continue to be the beneficial owner of the land/HK stock described in the said Assignment/Agreement for sale and purchase/Instrument of Transfer/Contract Notes.

(N.B. If the land/HK stock is to be sold or otherwise disposed of after the transfer/transactions, the full details should be disclosed.)

Given that the conditions for intra-group relief do not require the transferee to continue to be the beneficial owner of the asset concerned, the Institute would like to know the rationale for requiring an applicant to make the above declaration?

Mr Tam responded that the SDO did not prescribe any form of statutory declaration for the purposes of claiming stamp duty relief under section 45. He disclosed that standard formats were designed by the Law Society of Hong Kong with the agreement of the Collector which had been in use since 1976. The standard formats were subsequently slightly modified but the contents remained substantially the same.

Mr Tam indicated that whilst there was no explicit requirement under the SDO that the transferee had to continue to be the beneficial owner of the immovable property or HK stock concerned after the transfer, it was clear that the purpose of section 45 was to grant relief to transfers of beneficial interest in immovable property or HK stock between bodies genuinely associated so that the transfer did not involve a significant change of ownership. He explained that under the SDO, the Collector had to be satisfied that the circumstances stipulated in section 45(4) did not apply. He further explained that section 45(4) was an anti-avoidance provision to prevent abuse by claiming stamp duty relief by non-associated companies. He advised that if the transferee company did not have the intention to continue to be the beneficial owner of the immovable property or HK stock, there might be a possibility that the consideration, or any part of the consideration, for the transfer was to be provided or enabled to be provided directly or indirectly by a non-associated person. He also said that depending on the facts of the case, relief might be denied under the principle enshrined in *WT Ramsay Ltd v. Inland Revenue Commissioners* [1982] AC 300.
Mr Lean took the view that the requirement to declare that “the transferee had to continue to be the beneficial owner of the immovable property or HK stock concerned after the transfer” appeared to be redundant. Mr So mentioned that the particular clause in the statutory declaration form might serve to cater for the circumstance stipulated in section 45(4)(a). Both Mr Lean and Mr So queried the reason for such requirement. Mr. Lean mentioned that it seemed to add an unnecessary extra administrative burden.

Mr Tam responded that the statutory declaration would become insufficient and incomplete if that particular clause was to be taken out from the declaration form. CIR supplemented and referred to section 45(4)(b) which provided that the said interest was previously conveyed, transferred, purchased or sold, directly or indirectly, by a non-associated company. He also referred to section 45(2) which required that the effect of the relevant instrument had to convey or transfer a beneficial interest in immovable property or Hong Kong stock from one associated company to another. He elaborated that relief under section 45 was only available if the beneficial interest in the asset concerned had not, as part of any arrangement, been previously conveyed or transferred by a person who was not associated with the transferor or the transferee. He therefore concluded by saying that it would be necessary to have the particular clause in the declaration form to ensure that the transferee would continue to be the beneficial owner of the asset concerned.

(b) Associated relationship for intra-group relief

To qualify for the stamp duty exemption for intra-group transfer, the transferor and transferee must not cease to be associated within two years, by reason of a change in the percentage of the issued share capital of the transferee in the beneficial ownership of the transferor or a third corporation, under section 45(4)(c) of the SDO.

If the transferee amalgamates with another group company, within two years of the transfer of HK stock or immovable property, for which a section 45 exemption was claimed, would the exemption be affected?

In particular, the Institute would like to seek the IRD’s confirmation that the associated relationship would not be considered to have ceased even if the shares of the transferee (amalgamating company) are cancelled upon amalgamation. This is on the basis that the transferee (amalgamating company) has a 100% shareholding relationship with the surviving amalgamated company, and hence the latter should be considered to have a 90% or more shareholding relationship with the transferor.

Mr Tam clarified that although section 685(3)(b) of the Companies Ordinance provided that on the effective date of an amalgamation, each amalgamating company ceased to exist as an entity separate from the amalgamated company, the IRD considered that the amalgamation was not a situation contemplated by section...
45(5A) of the SDO even if the amalgamating company was the transferee in an immovable property or HK stock transfer. He pointed out that this was not a case where the transferor and the transferee ceased to be associated by reason of a change in the percentage of the issued share capital of the transferee in the beneficial ownership of the transferor or a third body corporate.

Mr Tam further clarified that if the transfer was between the amalgamated company and the amalgamating company and group relief had been granted, the relief would not be revoked as both companies would be treated as the same entity after amalgamation. He advised that in cases where the transfer was between the amalgamating company (as a transferee) and other associated body corporate, so long as the amalgamated company remained as an associated body corporate of the transferor company within the meaning of section 45(2) of the SDO within 2 years after execution of the instrument, section 45(5A) would not be invoked.
Agenda item A5 - Departmental policy and administrative matters

(a) E-filing of tax returns

According to the IRD’s current guideline, an individual can file his/her individual tax return through the internet if he/she:

- does not claim exemption in respect of part or all of his/her salaries income;
- does not own any sole proprietorship business with gross annual income of more than HK$2,000,000 for that year of assessment;
- does not have any deemed assessable profits pursuant to section 20AE and/or 20AF of the IRO for that year of assessment;
- has not obtained an advance ruling on any of his/her tax matters in relation to that year of assessment; and
- does not claim any double taxation relief pursuant to an arrangement specified under section 49(1) or 49(1A) of the IRO for that year of assessment.

Electronic filing of tax returns is now the norm in many developed markets and is even mandated in some. In this regard, could the IRD advise as to its plans/timetable for extending the e-filing system, so that more individuals and companies in HK can file electronically, including those with income exemption and double tax relief claims.

Ms Tsui advised that e-filing was one of the means to file the tax return – individuals (BIR60) and it was presently adopted on a voluntary basis in HK. Compared with the total number of BIR60s issued by the IRD every year, only a small number of taxpayers were affected by the conditions imposed. That said, consideration was being given to exploring various means to boost the usage rate of e-TAX services and the IRD would review the e-filing system to facilitate and encourage more individuals and companies in HK to file electronically.

Mr Ng mentioned that tax representatives often had to prepare tax returns for clients who stayed overseas and there was a practical difficulty in getting these clients to sign on the paper returns. It was common in overseas jurisdictions for tax representatives to be able to file on behalf of their clients. Mr So commented that given the global trend of e-filing of tax returns, it would be more efficient, flexible and cost-effective from the perspective of taxpayers if the scope of the present e-filing system would be extended. CIR responded that many people preferred completing paper returns by themselves because it was a simple process. He advised the Institute that extending the e-filing system would be part of the IRD’s long term business plan.
(b) Persons authorised to sign a profits tax return

Currently, the IRD accepts a profits tax return as a valid return if it is signed by one of the persons stipulated in section 57(1) (i.e. secretary, manager, director or liquidator of a corporation) or a designated person under section 57(2).

In this regard, the Institute would like to seek the IRD’s advice on:

(i) whether the return can be signed by a senior management personnel bearing designations other than those specified above, e.g. the group financial controller or the chief operating officer who are technically managers of the corporation

Mr Yim referred to section 57(1) of the IRO which provided that “(t)he secretary, manager, any director or the liquidator of a corporation and the principal officer of a body of persons shall be answerable for doing all such acts, matters, or things as are required to be done under the provisions of (the IRO) by such corporation or body of persons”.

Mr Yim said that, correspondingly, as stated in Profits Tax Return – Corporations (BIR51) Part 12 Declaration, the return was required to be signed by someone of the capacity of a secretary, manager, director or liquidator of a corporation, regardless of his/her specific designation. Mr Yim clarified that for that purpose, the terms “secretary, manager, director and liquidator” had the same meaning as those in the Companies Ordinance (Cap. 622) or the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32).

Mr Yim stressed that a corporation should ensure that its profits tax return was signed by a person in one of the four capacities as provided in section 57(1), although the person might hold a different designation in the corporation.

Mr Yim advised that members of the Institute should take note that section 57 was amended by the Securities and Futures (Amendment) Ordinance 2016 which had not yet commenced.

Mr Lean expressed his view that the manager as defined in Companies Ordinance (Cap. 622) would imply one level down, i.e. a person who performed managerial functions in relation to the company under the directors’ immediate authority. Mr Yim took note of his view.

(ii) if "yes", would the IRD also advise on how the company should complete the signatory section of the return, for example:
(1)  Delete all the titles specified in the signatory section of the return and type the title of the management person who signs the return, e.g. “GROUP FINANCIAL CONTROLLER”;  

(2)  Delete the titles specified in the signatory section of the return, except “MANAGER” and type the title of the management person who signs the return, e.g. “GROUP FINANCIAL CONTROLLER”; or  

(3)  Any other appropriate method (please specify).  

Mr Yim clarified that in Profits Tax Return - Corporations (BIR51), Part 12 Declaration, the capacity of the person who signed the return (secretary, manager, director or liquidator), rather than his/her specific designation, should be identified, with the inapplicable capacities deleted. He reminded the members of the Institute not to type the person’s specific designation or post title in the return.  

(c)  **Applying the definition of “ordinary resident” under Automatic Exchange of Information (AEOI)**

Under the AEOI regime, individuals are required to indicate their jurisdiction(s) of residence (including HK) in the self-certification form to be submitted to financial institutions (FIs). In this regard, the Institute would like to seek the IRD's views on the suggestions that the department:

(i)  consider issuing more guidelines on the conditions for qualifying as an “ordinary resident” in HK;  

(ii)  take into account the duration of the employment contract as one of the quantitative factors to be considered; and  

(iii)  consider the situation where dual residency is possible.  

CIR stated that whether an individual ordinarily resided in HK was a question of fact. He explained that an individual was generally considered “ordinarily residing” in HK if he has a permanent home in HK where his family lives. The legal principles were –  

(a)  “Ordinary residence” connoted residence in HK with some degree of continuity and apart from accidental or temporary absence.  

(b)  To be an ordinary resident of HK, the individual had to be habitually and normally resident in HK, apart from temporary or occasional absences of long or short duration. The concept of ordinary resident referred to an individual’s abode in HK which he had adopted voluntarily and for settled purposes, with a
sufficient degree of continuity, as part of the regular order of his life for the time being, whether of short or of long duration.

CIR indicated that the above guidelines had been uploaded to the OECD’s Automatic Exchange Portal as follows:


CIR pointed out that to determine whether an individual ordinarily resided in HK, the fact that he was holding a long term employment in HK was a relevant consideration.

CIR continued to say that under the AEOI regime, it was recognized that an individual might be resident in more than one jurisdiction of residence. He advised that though double taxation agreements might provide tie-breaker rules for determining residence in case of dual residence, it had been confirmed by OECD that this might not be too relevant.

CIR remarked that OECD’s position (which the IRD followed) was that reporting FIs were not expected to carry out independent legal analysis of relevant tax laws to confirm the reasonableness of a self-certification or determine the residence of account holders. He elaborated that tie-breaker rules in double tax treaties were for determining tax residence mainly for income tax purposes only but the scope of AEOI was wider and covered income taxes, inheritance taxes, value added taxes, and other taxes. Second, taxing rights were sometimes shared and not exclusive. Third, reporting FIs should not be in a position to decide whether an account holder was tax resident in one of two reportable jurisdictions under a double tax treaty between those two reportable jurisdictions to which HK was not a party.

CIR held the view that if it was established, whether through self-certification or not, that an account holder was resident in more than one reportable jurisdiction, the reporting FI was required to treat the account holder as resident in each respective jurisdiction and report the required information.

(d) **Penalty provisions for individual account holders under the AEOI regime**

Under section 80(2E) of the IRO, “a person commits an offence if the person, in making a self-certification ….., makes a statement that is misleading, false or incorrect in a material particular and knows, or is reckless as to whether, the statement is misleading, false or incorrect in a material particular”. A person who commits such offence is liable on conviction to a fine at level 3.

On the basis that a taxpayer may find it difficult to determine his tax residency and may not have the financial resources to obtain profession advice, the Institute would like to know whether the IRD would seek to impose a penalty for an inaccurate self-
certification form completed by a layman taxpayer who has only limited information with regard to determining his tax residency and has already completed the self-certification form on a “to the best of his knowledge” basis.

Mr Chiu said that under section 80(2E) of the IRO, an account holder would commit an offence if the account holder, in making a self-certification, (i) made a statement that was misleading, false or incorrect in a material particular; and (ii) he knew, or was reckless as to whether, the statement was misleading, false or incorrect in a material particular. He pointed out that the need to prove mens rea of “knowingly” or “recklessly” set a considerably high threshold for prosecution. He indicated that the IRD had to conduct investigation in the first place before being in a position to establish whether there were sufficient grounds to take prosecution actions.

(e) First exchanges under AEOI

For the purposes of exchange of financial account information under AEOI, HK has signed Bilateral Competent Authority Agreements (BCAA) with Japan and the UK to-date, with the first information year of 2017 (i.e. the reporting year will be 2018). If HK signs more BCAAs with other jurisdictions before March 2017, will the first information year for these new jurisdictions be 2018, or the remaining period of 2017 (say, July 2017)?

CIR told the meeting that the international community had been closely monitoring jurisdictions’ progress in the implementation of AEOI and putting emphasis on a wider network of AEOI to ensure a level-playing field. He disclosed that to overcome the challenges and to expand HK’s AEOI network speedily, the Government had introduced the Inland Revenue (Amendment) (No. 3) Bill 2017 to the Legislative Council on 29 March 2017. He said that the Bill sought to add 72 additional reportable jurisdictions in Part 1 of Schedule 17E to the IRO with the "reporting year" as "2018". That meant reportable accounts in respect of these new reportable jurisdictions had to be first reported to the IRD in 2018.

CIR mentioned that for the first round of reporting in 2018, FIs would be asked to furnish, for the 72 newly-added reportable jurisdictions, data with respect to the period from 1 July to 31 December 2017, whereas for Japan and the United Kingdom, data with respect to the period from 1 January to 31 December 2017. He said that in subsequent years, FIs were expected to furnish the IRD with full-year data for all jurisdictions included as “reportable jurisdictions”.

[Post meeting note: Inland Revenue (Amendment) (No. 3) Bill 2017 was passed by Legislative Council on 7 June 2017 and gazetted as Inland Revenue (Amendment) (No. 2) Ordinance 2017 on 16 June 2017. For the first information period in respect of each reportable jurisdiction, please refer to the IRD’s website as follows:}
(f) **Common Reporting Standard (CRS)**

The Institute would like to clarify the following:

(i) The Institute understands that HK CRS allows HK FIs to exclude the various categories of accounts from being treated as financial accounts, i.e. excluded accounts, such as dormant accounts. However, are such exclusions mandatory? Could an FI opt out of such exclusions (e.g. treat all dormant accounts as reportable financial accounts)?

Ms Mei said that the definition of “financial account” under the IRO excluded “excluded account”. She indicated that the IRO did not contain provision for election by FIs to opt out the excluded accounts (i.e. to treat all excluded accounts as financial accounts).

Ms Sarah Chan asked whether the exclusion of excluded accounts were at the discretion of FIs. Ms Mei replied in the negative.

(ii) If an account is treated as an excluded account for CRS purposes, we understand that due diligence procedures (including completion of CRS self-certification) would not be required to be performed on such accounts. However, could the IRD advise how FIs can establish that an account is an excluded account. We understand a copy of the deceased's will or death certificate can establish an account as Estate account. How about a retirement and pension account, non-retirement tax-favoured accounts and an escrow account?

Ms Mei explained that excluded accounts were contained in Part 3 of Schedule 17C to the IRO, which set out the requirements for a particular category of account to be treated as excluded account. She said that an FI should follow the rules to exclude the accounts that met the definition of excluded accounts. She further said that the FI might rely on information in its possession (including information collected pursuant to AML/KYC procedures) or that was publicly available, based on which it could reasonably determine that the account was an excluded account.

(iii) We understand that when an FI performs due diligence procedures to the account holders, FI must perform the "reason to know" check to validate self-certification or documentary evidence against the account holders’ information. Besides, we understand that nationality is not an indicia or reportable information under HK CRS. However, if the FI has in its record the account holder's (i) Mainland passport, (ii) Mainland household register (中華人民共和國
(iii) Exit-Entry Permit for Travelling to and from HK and Macau (中华人民共和国往來港澳通行證), and/or (iv) any other documentations that indicate the account holder's Mainland nationality, it is very likely that such account holder is a Mainland resident for the Mainland tax purposes and subject to the Mainland taxation. In such circumstances, would an FI be required to ask for additional information if such account holder does not indicate its Mainland tax residency on his self-certification, even though nationality is not an indicia for CRS purposes?

Mr Chiu stated that the IRO imposed obligations on reporting FIs to collect valid self-certifications for new accounts. He indicated that the self-certification had to allow the reporting FI to determine the account holder's residence(s) for tax purposes, and confirm the reasonableness of such self-certification based on information obtained by the reporting FI in connection with the opening of the account, including any documentation collected pursuant to AML/KYC procedures.

Mr Chiu elaborated that section 2 of Part 7 in Schedule 17D to the IRO contained the standard of knowledge applicable to a self-certification or documentary evidence. It provided that a reporting FI might not rely on self-certification or documentary evidence if it knew or had reason to know that the self-certification or documentary evidence was incorrect or unreliable. He envisaged that a reporting FI had reason to know that a self-certification provided by a person was unreliable or incorrect if the self-certification was incomplete with respect to any item on the self-certification that was relevant to the claims made by the person. He, therefore, took the view that a reporting FI should not rely on a self-certification in which the account holder failed to provide his jurisdiction of residence for tax purposes. Such self-certification was not valid for due diligence purposes. He said that other documentations that indicated the account holder’s nationality could assist reporting FIs in performing reasonableness test.

Both Ms Sarah Chan and Mr Anthony Tam raised concern that where an account holder was a resident in HK but his other records, such as Mainland household register (中华人民共和国居民戶籍簿), indicated his Chinese nationality because of his domicile in the Mainland. Mr Chiu responded that the Institute’s question related to a dual resident case where the account holder was also a Mainland resident. He continued to explain that a reporting FI had to discharge its due diligence obligations under the IRO to identify those accounts that are held by residents of reportable jurisdictions. In case where an account holder was a resident in different reportable jurisdictions, the account holder should be reported as resident of these reportable jurisdictions.
(iv) We understand that a self-certification must be signed by the account holder, or in the case of an account opened by telephone or internet, the self-certification must be positively affirmed. However, we also understand that the reporting FI must be able to provide a hard copy of all self-certification to the IRD on request if the self-certification is collected electronically. As such, if the personnel of a reporting FI is going to obtain, confirm and verify the self-certification with its clients through a voice recording phone, without collecting the self-certification in paper form from clients, is it feasible for the reporting FI to only provide the relevant audio tape to the IRD on request? Or is it suggested that the reporting FI should also collect the self-certification in physical or electronic paper form, when using voice recordings?

Mr Chiu responded that the self-certification might be provided in any manner and in any form, for example, it could be in paper or electronic format. He said that if the self-certification was provided electronically, the reporting FI had to have systems in place to ensure that the information provided was that of the account holder and it had to be able to provide a hard copy of all such self-certifications to the IRD on request. Mr Chiu therefore suggested that reporting FI should also collect the self-certification in physical or electronic paper form, when using voice recordings.

(v) The AEOI legislation imposes obligations on reporting FIs. FI, includes, among others an “investment entity”. If a company holds a SFC licence to carry out “asset management activities” (i.e. Type 9 SFC licence) but the entity does not hold any client assets (that is, the entity merely provides advice), can the entity be excluded from the AEOI reporting obligation?

Mr Chiu explained that by virtue of the definitions of “reporting financial institution” and “investment entity” under the IRO, a corporation that held a Type 9 SFC licence to carry out asset management activities was regarded as a reporting FI. He further explained that while the due diligence and reporting obligations under Part 8A of the IRO applied to a reporting FI, the reporting FI would have to fulfil the obligations only if it maintained financial accounts. He pointed out that a Type 9 licence holder that did not hold any client assets was not considered as maintaining custodial accounts. In addition, the definition of “financial account” excluded equity or debt interest in respect of an advising manager where it was an investment entity solely because it (i) rendered investment advice to, and acted on behalf of, or (ii) managed portfolios for, and acted on behalf of, a customer for the purpose of investing, administering, or managing financial assets deposited in the name of the customer with an FI other than the advising manager. He therefore concluded that an advising manager who only provided investment advice and did not maintain any financial account on its own, would not normally have any reporting obligations.
Would the IRD advise whether the reportable information to be reported through the future IRD AEOI portal (e.g. name, address) have to be in English only. Would Chinese or other languages be accepted? For example:

(1) What if account holders provide a name or address in Chinese only as a Chinese self-certification form is available, or in other languages, such as Japanese and Korean, assuming the reporting FIs can capture and validate such information?

(2) What if there is no English name at all (e.g. some Chinese entities have no English name under the registration documents)?

Ms Peggy Leung said that the IRD had developed a data schema (Schema) in Extensible Markup Language (XML), which was based on the CRS XML Schema (v1.0) issued by the OECD, to specify the format for reporting the required financial account information. She further said that the IRD had also published the Financial Account Information Return XML Schema User Guide (User Guide) to explain the requirements for each data element in the Schema. She indicated that reporting FIs had to follow the Schema to create data files containing the required information.

Ms Peggy Leung pointed out that there was no specific requirement on the language used for inputting data. She said it was defined in the Schema that “Name” and “address” data elements should be filled with generic characters. She took the view that the languages quoted in the Institute’s example were all acceptable provided that the characters were encoded in UTF-8 (i.e. 8-bit Unicode Transformation Format).

Ms Peggy Leung, however, stated that reporting FIs should be aware that some special characters were not acceptable within a data file. She advised that reference might be made to Part C paragraph 2 of the User Guide.

Based on the IRO, the Institute understands that a collective investment scheme (CIS) authorised under the Securities and Futures Ordinance (SFO) is an investment entity, i.e. an FI, for CRS purposes. Assuming a Fund is set up in Cayman Islands and is a CIS scheme authorised under the SFO (and also normally managed and controlled in HK), the Institute understands that it would be treated as an FI for both Cayman Islands and HK.

Further, under HK CRS Guidance, if an FI is a resident in HK and also in another country, it will still need to undertake the appropriate due diligence procedures and report any reportable accounts maintained in HK.

(1) Could the IRD advise whether the place where accounts are "maintained" refers to the location of books and records of the account holders (e.g.
the investor register for a fund).

(2) If the accounts are maintained in Cayman Islands only, could the IRD confirm that such FI would not be required to perform any due diligence procedures on its accounts holders.

(3) If the accounts are maintained in Cayman Islands only, would the FI is still be required to report to the IRD (e.g. submission of a nil report)?

To the question in (f)(vii)(1), Ms Peggy Leung answered “no” and said that the place where accounts were maintained did not merely refer to the location of books and records of the account holders. She explained that if an entity was a reporting FI in HK, it would be required to fulfil the due diligence and reporting obligations under Part 8A of the IRO, i.e. to review all financial accounts that it maintains and report on reportable accounts. She said that there were, however, special rules under the CRS that governed multiple resident situations of a reporting FI. First, where an entity, other than a trust, was resident in two or more participating jurisdictions, it was required to report the financial account(s) it maintained to the tax authorities in each of the jurisdiction(s) in which it maintained them. Second, in the case of a trust, it was considered to be resident for reporting purposes in the participating jurisdiction where one or more of its trustees were resident, unless all the information required to be reported in relation to the trust was reported to another participating jurisdiction’s tax authority because it was treated as resident for tax purposes there. Therefore, she clarified that if a CIS established in the form of trust was a reporting FI in HK, it would be required to undertake the due diligence and reporting obligations in respect of all financial accounts that it maintained. She further clarified that for reporting, if it was established that all the information required to be reported in relation to the CIS was reported to another participating jurisdiction’s tax authority because it was treated as resident for tax purposes there, the CIS might be exempt from filing reportable accounts in HK. She indicated that this relief was subject to application in each year.

In replying to Mr Anthony Tam’s question concerning a trust established in Cayman Islands, Mr Chiu said that if the trustee was a resident in HK, the trust was also a reporting FI in HK and had to do reporting in HK.

Ms Sarah Chan asked whether the answer to questions (f)(vii)(2) and (3) in both cases should be "no". Mr Chiu said that there was a distinction between trust and other entities. If a non-HK resident corporate FI had a branch in HK, the branch would be a reporting FI and would be required to report on HK accounts. For a trust, he said that if any trustee was in HK, the trust would have to report all account information in HK unless it was established that all the information required to be reported in relation to the trust was reported to another participating jurisdiction’s tax authority because the trust was treated
as resident for tax purposes there.

(viii) A company which is a security company (i.e. reportable FI for AEOI purpose) has numerous account holders (i.e. clients) which are overseas (i.e. non-HK) securities companies/brokerage companies. Does the company need to apply due diligence procedures (including the sending of self-certification forms) to these overseas securities companies/brokerage companies (in view of the fact that these account holders may also be reportable FIs themselves for AEOI purposes)?

Ms Peggy Leung explained that section 50B of the IRO imposed obligations on reporting FI to identify reportable accounts in accordance with the due diligence requirements in Schedule 17D. Therefore, reporting FIs were required to apply due diligence procedures (including the sending of self-certification forms) in respect of all financial accounts that they maintained. She further explained that if it was established through the due diligence procedures that the account holder is an overseas FI, the HK FI was not required to report on that overseas FI as FI was specifically excluded from the definition of “reportable person” under section 50A(1) of the IRO.

(ix) Could the IRD advise whether cash/foreign currency are financial assets in the context of the HK CRS. If not, please advise on the following:

(1) If an FI (e.g. a leveraged foreign exchange trading company licensed under the SFO, i.e. a reporting FI for HK CRS purposes), enters a foreign currency swap/option/forward contract with a customer directly (i.e. the FI does not hold the foreign currency contract on behalf of the customer) and the FI accepts some margins or collateral (in terms of cash only) under such contractual arrangement, would this customer account constitute a custodial account (i.e. financial account) for CRS purposes?

(2) Paragraph 18 of Chapter 5 of HK CRS Guidance states that,

"Transactions which include the collection of margin or collateral on behalf of a counterparty may fall within the definition of custodial account. The exact terms of the contractual arrangements will be relevant in applying this interpretation. However, if collateral is provided on a full title transfer basis, so that the collateral holder becomes the full legal and beneficial owner of the collateral during the term of the contract, this will not constitute a custodial account for the purposes of AEOI."

However, if cash is not financial assets, would such account still fall within the definition of custodial account since the FI is not holding financial asset on behalf of the client?
Ms Peggy Leung disclosed that the IRD, at present, had followed the view of the UK that cash was not a financial asset. It followed that if a leveraged foreign exchange trading company (an FI) did not hold the foreign currency contract on behalf of the customer, but accepted some margins or collateral in cash only under the contractual arrangement, this arrangement would not constitute a custodial account for CRS purposes.

Ms Peggy Leung drew the Institute members’ attention that paragraph 18 of Chapter 5 of the Guidance for Financial Institutions referred to those collateral accounts that involved financial assets, but not cash.

For HK CRS purposes (under both CRS guidance and the IRO), the Institute understands that cash value of an insurance contract does not include “an amount payable under an insurance contract as a return of an advance premium or premium deposit for an insurance contract for which the premium is payable at least annually if the returned amount of the advance premium or premium deposit does not exceed the next annual premium that will be payable under the contract”.

Generally, a medical insurance or general insurance policy has no cash value, which is not in-scope for CRS purposes. However, if the policyholder has paid advance premium that exceeds that next year’s annual premium payable, e.g. made a payment covering five years, could the IRD advise whether this means such insurance contract would be treated as a cash value insurance contract, which then becomes in-scope for CRS purposes?

Ms Peggy Leung informed that the enquiries had been relayed to the OECD and said that a reply would be provided later.

[Post meeting note: It is the view of the IRD that if a policyholder has paid advance premium for an insurance contract that exceeds the next annual premium that will be payable under the contract, the advance premium will be a cash value for CRS purposes.

The term “cash value insurance contract” is defined to mean an insurance contract (other than an indemnity reinsurance contract between two insurance companies) that has a cash value. Insurance contract means a contract, other than an annuity contract, the issuer of which agrees to pay an amount on the occurrence of a specified contingency involving mortality, morbidity, accident, liability, or property risk. A cash value is the greater of (1) the amount that the policyholder of an insurance contract is entitled to receive on surrender or termination of the contract, or (2) the amount that the policyholder can borrow under or with regard to the contract. The term “cash value” makes reference to an insurance contract, which should cover medical insurance or general insurance policy. However, this term excludes, among
others, any return of an advance premium or premium deposit for an insurance contract for which the premium is payable at least annually if the returned amount does not exceed the next annual premium that will be payable under the contract.

In the example quoted, as the advance premium (1) constitutes a cash value (i.e. as the amount that the policyholder is entitled to receive on surrender or termination of the contract or as the amount that the policyholder can borrow under or with regard to the contract) and (2) fails to meet the requirements for exclusion, the advance premium is treated as cash value and the relevant contract is cash value insurance contract subject to CRS reporting.]

(g) Lodgment of tax returns and filing deadlines for 2016/17

The Institute would be interested to know the latest statistics on the filing of tax returns and the filing deadlines for 2016/17.

Mr Yim referred the meeting to four tables in Appendix A. Table 1 showed that the IRD had issued some 3,000 more returns in the 2015/16 bulk issue exercise and some 19,300 returns were not filed by the due dates. Table 2 showed the filing position under different accounting codes. Table 3 showed the progressive filing results. He pointed out the overall performance was very unsatisfactory given that the lodgment rate for “D” code returns by the deadline dropped to 77% while that for “M” code returns remained at 78%. The progress lodgments were also not good and remained significantly below the lodgment standards. Mr Yim 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 2016/17 Profits Tax Returns

Mr Yim said that the 2016/17 Profits Tax Returns for “active” files would be bulk-issued on 3 April 2017. The extended due dates for filing 2016/17 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>4 May 2017</td>
<td>18 May 2017</td>
</tr>
<tr>
<td></td>
<td>(no extension)</td>
<td></td>
</tr>
<tr>
<td>“D” code</td>
<td>15 August 2017</td>
<td>29 August 2017</td>
</tr>
<tr>
<td>“M” code</td>
<td>15 November 2017</td>
<td>29 November 2017</td>
</tr>
<tr>
<td>“M” code – current year loss cases</td>
<td>31 January 2018</td>
<td>31 January 2018 (same as paper returns)</td>
</tr>
</tbody>
</table>
CIR supplemented and reminded tax practitioners to file tax returns on time. In replying to Mr Anthony Tam’s enquiry regarding the performance in the previous year, CIR suggested that he refer to the analysis at Appendix A.
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 2016. Comparative figures for the years 2014 and 2015 were included.

Ms Connie Chan reported that Field Audit teams uncovered discrepancies in 335 corporation cases, of which 265 carried clean auditors’ reports. She said that the amount of discrepancies detected in the clean report cases accounted for 88% (2015: 94%) of the total discrepancies detected in the year 2016 and total tax of $626 million was recovered from these cases. Average understatement per clean report case was $15.07 million (2015: $9.79 million) while tax undercharged per clean report case was $2.4 million (2015: $1.5 million).

Ms Connie Chan noted that discrepancies in 2016 resulted mainly from incorrect claims of offshore profits, technical adjustments and understatement of gross profits. She said that the discrepancies in the majority of cases were detected after examining the business ledgers and source documents.

Mr Ng noted that the cases involved closed years, which could relate back to different years of assessment. As such, the findings could not provide any clear indication of trends. Ms Connie Chan agreed.

Ms Sarah Chan referred to Appendix B and pointed out that there was a significant increase in the discrepancies detected in the year 2016 under the category of technical adjustments as compared with previous years. She asked the nature of such technical adjustments. Ms Connie Chan replied that such increase mainly came from adjustments in depreciation allowances, stock valuation, reduction in tax losses, etc.

Ms May Leung asked how transfer pricing adjustments were reflected in the analysis at Appendix B. CIR replied that transfer pricing adjustments were not covered in the analysis as it showed the results of field audit cases only.

Agenda Item B2 – Date of Next Annual Meeting

The date would be agreed between the Institute and the IRD in due course.
### Lodgement of Corporations and Partnerships Profits Tax Returns

#### Table 1
Lodgement Comparison from 2013/14 to 2015/16

<table>
<thead>
<tr>
<th></th>
<th>2013/14</th>
<th>2014/15</th>
<th>2015/16</th>
<th>Comparison 2014/15 and 2015/16</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>1. Bulk issue (on 1 April)</strong></td>
<td>186,000</td>
<td>185,000</td>
<td>188,000</td>
<td>2%</td>
</tr>
<tr>
<td><strong>2. Cases with a failure to file by due date:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>'N' Code</td>
<td>2,200</td>
<td>2,100</td>
<td>2,200</td>
<td>5%</td>
</tr>
<tr>
<td>'D' Code</td>
<td>6,000</td>
<td>5,900</td>
<td>6,600</td>
<td>12%</td>
</tr>
<tr>
<td>'M' Code</td>
<td>10,300</td>
<td>10,400</td>
<td>10,500</td>
<td>1%</td>
</tr>
<tr>
<td></td>
<td>18,500</td>
<td>18,400</td>
<td>19,300</td>
<td>5%</td>
</tr>
<tr>
<td><strong>3. Compound offers issued</strong></td>
<td>7,100</td>
<td>7,500</td>
<td>6,600</td>
<td>-12%</td>
</tr>
<tr>
<td><strong>4. Estimated assessments issued</strong></td>
<td>7,100</td>
<td>7,400</td>
<td>8,300</td>
<td>12%</td>
</tr>
</tbody>
</table>

#### Table 2
2015/16 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>64,000</td>
<td>104,000</td>
<td>188,000</td>
</tr>
<tr>
<td>Failure to file on time</td>
<td>2,200</td>
<td>6,600</td>
<td>10,500</td>
<td>19,300</td>
</tr>
<tr>
<td>Compound offers issued</td>
<td>800</td>
<td>2,600</td>
<td>3,200</td>
<td>6,600</td>
</tr>
<tr>
<td>Estimated assessments issued</td>
<td>900</td>
<td>2,800</td>
<td>4,600</td>
<td>8,300</td>
</tr>
</tbody>
</table>
Table 3
Represented Profits Tax Returns - Lodgement Patterns

<table>
<thead>
<tr>
<th>Code</th>
<th>Lodgement Standard</th>
<th>2015/16 PTRs</th>
<th>2014/15 PTRs</th>
</tr>
</thead>
<tbody>
<tr>
<td>D - 15 August</td>
<td>100%</td>
<td>77% (1)</td>
<td>80%</td>
</tr>
<tr>
<td>M - 31 August</td>
<td>25%</td>
<td>11%</td>
<td>10%</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>32%</td>
<td>31%</td>
</tr>
<tr>
<td>M - 15 November</td>
<td>100%</td>
<td>78% (2)</td>
<td>78%</td>
</tr>
</tbody>
</table>

(1) 35% lodged within a few days around 15 August 2016 (30% lodged within a few days around 17 August 2015 for 2014/15 PTRs)

(2) 30% lodged within a few days around 15 November 2016 (30% lodged within a few days around 16 November 2015 for 2014/15 PTRs)

Table 4
Tax Representatives with Lodgement Rate of less than 78% of 'M' code Returns as at 15 November 2016

1,484 T/Rs have 'M' Code clients. Of these, 684 (46%) 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>No. of firms</td>
</tr>
<tr>
<td>Small size firms 100 or less</td>
<td>100</td>
</tr>
<tr>
<td>Medium size firms 101 - 300</td>
<td>114</td>
</tr>
<tr>
<td>Large size firms over 300</td>
<td>7</td>
</tr>
<tr>
<td>Total 1,484 684 7,845 100%</td>
<td>1,498 700 8,249 100%</td>
</tr>
</tbody>
</table>
### Table 1 [Appendix B]
Analysis of Completed FA Corporation Cases for the years ended 31 December 2014, 2015 and 2016

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales omitted</td>
<td>37</td>
<td>79</td>
<td>48</td>
<td></td>
<td>21</td>
<td>7</td>
<td>14</td>
<td></td>
</tr>
<tr>
<td>Purchases overstated</td>
<td>11</td>
<td>7</td>
<td>12</td>
<td></td>
<td>3</td>
<td>1</td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>Gross profit understated</td>
<td>34</td>
<td>29</td>
<td>34</td>
<td></td>
<td>12</td>
<td>9</td>
<td>16</td>
<td></td>
</tr>
<tr>
<td>Expenses over-claimed</td>
<td>80</td>
<td>103</td>
<td>79</td>
<td></td>
<td>16</td>
<td>13</td>
<td>16</td>
<td></td>
</tr>
<tr>
<td>Technical adjustments</td>
<td>81</td>
<td>105</td>
<td>79</td>
<td></td>
<td>27</td>
<td>13</td>
<td>18</td>
<td></td>
</tr>
<tr>
<td>Offshore income / profits disallowed</td>
<td>25</td>
<td>16</td>
<td>18</td>
<td></td>
<td>4</td>
<td>1</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td>97</td>
<td>137</td>
<td>78</td>
<td></td>
<td>3</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>365*</td>
<td>476*</td>
<td>348*</td>
<td></td>
<td>113*</td>
<td>68*</td>
<td>96*</td>
<td></td>
</tr>
</tbody>
</table>

| Average Amount Per Case      | $1,773,976                     | $2,028,582 | $2,591,297 | $1,475,584 | $716,420 | $1,882,030 |

* in one case there may be more than one type of discrepancy

Total Discrepancy for All Years

<table>
<thead>
<tr>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>$3,644,386,335</td>
<td>$3,554,239,498</td>
<td>$3,992,788,229</td>
</tr>
</tbody>
</table>

| Average Amount Per Case      | $1,261,033,333 | $9,791,293 | $15,067,125 | $1,475,584 | $716,420 | $1,882,030 |

Other statistics for the above cases:

| Total Amount                  | $660,427,326 | $224,762,950 | $355,242,825 | $8,053,992 | $4,682,561 | $7,646,326 |

| Average Amount Per Case      | $20,583,660 | $7,164,200 | $11,882,030 | $236,165 | $87,084 | $202,310 |

* in one case there may be more than one type of discrepancy

Total Tax Undercharged for All Years

<table>
<thead>
<tr>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>$451,579,567</td>
<td>$544,448,403</td>
<td>$625,741,686</td>
</tr>
</tbody>
</table>

| Average Amount Per Case      | $1,562,559 | $1,499,858 | $2,361,289 | $1,279,856 | $655,762 | $1,064,118 |

Other statistics for the above cases:

| Total Amount                  | $4,304,813,661 | $3,779,002,448 | $4,528,031,054 | $11,603,271 | $9,194,653 | $13,516,511 |

| Average Amount Per Case      | $11,603,271 | $9,194,653 | $13,516,511 | $1,500,075 | $1,401,277 | $2,090,239 |

Total Discrepancy for All Years

<table>
<thead>
<tr>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>$604,273,326</td>
<td>$224,762,950</td>
<td>$355,242,825</td>
</tr>
</tbody>
</table>

| Average Amount Per Case      | $8,053,992 | $4,682,561 | $7,646,326 | $1,279,856 | $655,762 | $1,064,118 |

Total Tax Undercharged for All Years

<table>
<thead>
<tr>
<th>2014</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>$104,948,232</td>
<td>$31,476,587</td>
<td>$74,488,239</td>
</tr>
</tbody>
</table>

| Average Amount Per Case      | $11,603,271 | $9,194,653 | $13,516,511 | $1,500,075 | $1,401,277 | $2,090,239 |

Other statistics for the above cases:

| Total Amount                  | $4,304,813,661 | $3,779,002,448 | $4,528,031,054 | $11,603,271 | $9,194,653 | $13,516,511 |

| Average Amount Per Case      | $11,603,271 | $9,194,653 | $13,516,511 | $1,500,075 | $1,401,277 | $2,090,239 |
## Extracts of Analysis in Appendix B

<table>
<thead>
<tr>
<th>(a) No. of corporation cases with discrepancies uncovered</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>411</td>
<td>335</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(b) No. of corporation cases in item (a) carried clean auditor’s reports</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>363</td>
<td>265</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(c) Total discrepancies detected in all cases</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$3,779m</td>
<td>$4,528m</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(d) Total discrepancies detected in clean auditor’s report cases</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$3,554m</td>
<td>$3,993m</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(e) Percentage of (d) over (c)</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>94%</td>
<td>88%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(f) Total tax uncovered in clean auditor’s report cases</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$544m</td>
<td>$626m</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(g) Average understatement per clean auditor’s report case</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$9.79m</td>
<td>$15.07m</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>(h) Tax undercharged per clean auditor’s report case</th>
<th>2015</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>$1.5m</td>
<td>$2.4m</td>
</tr>
</tbody>
</table>