(iv) It is noted that the Japan DTA and Luxembourg protocol have specified articles for arbitration. The Institute requests IRD to provide more details of the mechanism and whether arbitration articles will be included in future CDTAs.

Mr Wong advised that the OECD in its Model Tax Convention issued in July 2008 introduced the arbitration provisions and it was now an international trend to adopt these provisions. These provisions would be adopted in the CDTAs if Hong Kong and its treaty partners both considered it desirable and appropriate to do so. The OECD Model Tax Convention contained a sample agreement for implementing the arbitration provisions, which would form the basis of the IRD's negotiation with Hong Kong's treaty partners. CIR said that, currently, three of Hong Kong's CDTAs contained arbitration provisions.

Agenda item A5 - Departmental policy and administrative matters

(a) Employer's withholding obligation under Hong Kong salaries tax

An employer is required to comply with the withholding requirement under section 52(7) to withhold from making any payment of money or money's worth to or for the benefit of the employees who are about to depart from Hong Kong, for a period of one month from submitting the notice required under section 52(6) (which is the Form IR56G). In relation to this, the Institute would like to clarify the following:

In the case where the employees would exercise stock options or be vested with restricted shares within the one month withholding period, it would be difficult for the employers to comply with the withholding requirement because (i) there is no payment of cash by the employer to the employees and (ii) the transactions of exercise and vesting would be handled directly by intermediates such as banks and brokerage houses. As there is no payment by the employer to the employee, would the IRD accept and/ or agree that the employer is not required to comply with the withholding requirement on the income derived from the stock option exercised or restricted shares vested in these circumstances? If not, can the IRD provide any practical suggestions to the employer for complying with the withholding requirement?

Mrs Lai advised that section 52(7) applied to situations where there was a “payment of money or money’s worth”. It was not restricted to the payment of cash by the employer. The act of payment should not be narrowly interpreted so as to limit it to direct cash payment. If an employer instructed or caused a payment to be made, it was a payment within section 52(7) e.g. an employer instructed the banker to make a payment to the employee.

Mrs Lai explained that section 52(7) did not impose a withholding tax on the payment to be made to the employee. It simply required the employer not to make any payment for a period of one month from the date of the notice given under section 52(6). Section 52(7) provided a mechanism which ensured that the taxes of the employee who was about to leave Hong Kong upon cessation of employment would be settled before his departure.

Mrs Lai suggested that the practical suggestions were: not to make any payment (in money or money’s worth) and not to cause any payment to be made to the employee for a period of one month from the date of the notice given under section 52(6); provide full details of the remuneration to be given to the employee in an IR56G, including share options and share awards, whether vested or not; payment could only be made within one month if a letter of release had been issued by the IRD.

Mrs Lai remarked that in DIPN 38, the reporting requirements on an employer were explained in paragraphs 79 to 83.

The obligation under section 52(6) applies before employees have left Hong Kong. There is no obligation to make a notice under section 52(6) if an employee has already left Hong Kong. If an employer had already complied with the withholding requirement ("the first withholding") upon submitting the Form IR56G in the previous tax year for a departed employee, and is going to file an additional Form IR56G to report the further income payable to the departed employee in the current tax year, it is understood that the IRD requires the employer to withhold the additional income upon submitting the subsequent Form IR56G ("the second withholding"). Legally there is also an argument that there is no statutory obligation for the employer to provide another notice under section 52(6) (using Form 56G) in this case, as the employee has already left. As such there will be no withholding obligation for the employer under section 52(7), as there is no notification under section 52(6). It would appear that the withholding requirement under section 52(7) will only apply when the first Form IR56G is filed, but not that when the additional Form IR56G is to be filed, even if Form 56G is used.

Would the IRD clarify the legal obligation of employers under section 52(6) and section 52(7) in this situation and confirm that employers will still be indemnified under section 52(7) by the IRD, in the event of any proceedings against them for failure to make payment to or for the benefit of the employees concerned during the period of the second withholding?

Mrs Lai advised that as explained above, section 52(7) did not impose a withholding tax. Provisions in section 52(7) would apply if the employer had ceased or was about to cease to employ an employee who was about to leave Hong Kong. Prima facie, section 52(7) would be inapplicable one month after the date on which the first notice under section 52(6) was given in respect of the employee.

Mrs Lai explained that section 52(7) contained no provision on indemnity as claimed. It only provided that compliance with this subsection would constitute a defence in any proceedings against an employer in respect of his failure to make any payment to or for the benefit of the individual during the one-month period.

Mrs Lai further explained that in cases where an amended IR56F or IR56G form was filed in respect of the cessation year (year in which share awards were deemed to have accrued under section 11D(b)(ii)) or where a subsequent IR56B was filed in respect of a year of assessment after the cessation year (year in which stock option was exercised or assigned), the employer should take note that the relevant additional assessment or assessment would be raised with a very short or immediate due date for payment and recovery action would be taken promptly under section 76. An employer who complied with a notice issued under section 76(1) would be indemnified under section 76(2).

Mrs Lai pointed out that section 76 applied to situations where the employee had quitted Hong Kong or the employee was likely to quit Hong Kong without paying his taxes.

(b) Whether a holdover of the provisional tax can be made based on a later issue or payment dates of a revised section 64(3) assessment

Under sections 63E/J/O, a taxpayer may apply for holdover of the provisional salaries/ profits/ property tax on the grounds stipulated in those sections, on or before the specified dates. The specified date is the later of:

(i) 28 days before the day by which the provisional tax is to be paid; or
(ii) 14 days after the date of the notice for payment of provisional tax.

The following example is used to illustrate this question. An assessment of HK$10,500,000 was issued and the taxpayer objected to the assessment on the grounds that HK$500,000 being disallowed by the assessor was wrong. As a result of the objection, final tax and the provisional tax related to the item in dispute of HK$500,000 were held over. Subsequently, the assessment was revised under section 64(3) to HK$10,000,000, as the assessor agreed with the taxpayer that the item of HK$500,000 should be an allowable deduction. The revised assessment was issued with final tax and provisional tax demanded on the now revised assessable profit of HK$10,000,000, and the payment dates for the taxes demanded were later than those specified in the original assessment.