(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.

The Institute would like to clarify whether the taxpayer can now make a holdover claim based on the later issue or tax payment dates, as specified in the revised assessment, on grounds other than that the assessment is under objection. For example, can the taxpayer now claim for holdover of the provisional tax as demanded by the revised assessment, on the grounds that its estimated assessable profit for the following year is less than 90% of HK$10,000,000 - if the time limit for a holdover claim based on the original assessment has now lapsed?

Mrs Lai advised that if taxpayers had other grounds to apply for holdover of provisional tax, they should lodge additional holdover claims within the stipulated time rather than waiting for the settlement of their objections. Normally, the IRD did not adjust the due date for payment of the provisional tax when revising an assessment. For purposes of sections 63E/J/O, the date of the original notice for payment of the provisional tax was taken to be "the date of the notice for payment of provisional tax".

(c) Advance ruling

Tax representatives note that the IRD is generally very reluctant to give rulings except in very clear cut cases. This is particularly so for ruling applications on capital verses revenue treatments. The Institute considers that this is against the main objectives of the advance ruling service, which are to provide taxpayers with a degree of certainty, promote consistency in the application and minimise disputes between the IRD and taxpayers. These objectives are stated in DIPN 31, with which the Institute agrees.

For ruling applications on capital verses revenue treatments, the IRD often declines to give rulings on the grounds that the applications require the commissioner to determine or establish any question of fact. DIPN 31 makes it clear that the commissioner may decline to make a ruling if the application seeking the ruling would require the commissioner to determine or establish any question of fact. However, the Institute understands that the IRD has declined to rule on the treatment of capital or revenue based on a set of facts stated. It is understood that the tax authorities in other jurisdictions, such as Canada, will give advance rulings on capital versus revenue transactions.

The Institute requests the IRD to clarify its position on this issue.

Mr Wong advised that the perception that the IRD was reluctant to give rulings except in very clear cut cases was not correct. In 2010, the IRD declined only one case where the application involved an issue on capital vs revenue, which was a minor percentage of the overall number of such applications. Although ruling applications invariably contained descriptions of the related facts, very often such descriptions were insufficient for the Commissioner to give a ruling. Ascertainment of facts in, for example, property dealing cases was a long process. Schedule 10 paragraph 2(a) of the IRO clearly stated that the Commissioner may decline to make a ruling if the application required the Commissioner to determine or establish any question of fact. It was inappropriate to compare Hong Kong with other tax jurisdictions.

CIR added that there was no policy to decline applications for a ruling on issues concerning capital vs revenue. Ms Macpherson agreed that tax practitioners should endeavour to provide full facts of the case in order to enable the IRD to make a ruling.

(d) Timing of issuing the sample tax return

Currently, profits tax returns are issued to taxpayers at the beginning of April each year in general. In addition, a sample profits tax return, as well as the information about the major changes to the return (if any) for the given year of assessment are posted on the IRD's website around the same time.

It takes time for the tax representatives and their clients to get familiar with the changes to the tax return and in some cases to integrate their tax compliance software with the new design. In order to expedite the return filing for the "N" Code taxpayers within one month from issuance, the Institute would like to ask whether the IRD could issue the sample tax return, together with the explanatory note to the return earlier, say one month before the issue of tax returns in early April each year. This would help improve the efficiency for completing the tax returns for "N" Code taxpayers.

Ms Lee advised that in order not to cause confusion to the public, the sample tax return on IRD's website should be the version in use. To enable tax representatives to get familiar with the changes, the IRD would send, in early March, samples of tax returns (BIR 51 and BIR 52 forms) together with the notes and instructions in pdf format, to those who have registered for email service with the IRD via emails. However, where tax representatives had questions regarding the changes, they should raise these after the new sample tax return is uploaded to the IRD's website.

CIR further advised that tax representatives who have registered for email service with the IRD, and most have now done so, would receive notifications through emails about "What's New" on the IRD's website.

(e) On-line forms/filing

The Institute would like to ask:

(i) Whether the IRD could simplify the filing procedures for various forms, e.g. allowing the use of standard on-line forms, which the taxpayer can print off and sign, or where the taxpayer is permitted to sign on a scanned copy. On tax assessments, the Institute would like to ask if they could be made available on-line for the taxpayers or their representatives.

Mrs Chu advised that over 100 public forms and pamphlets under 12 categories were now downloadable from the IRD website. If registration for *eTax* service had been made, salaries tax assessments on individuals taxpayers would also be made available on-line to the taxpayers but not to their representatives. For taxpayers other than individuals, there was no plan yet to issue assessments on-line.

(ii) When the next phase of the e-corporate tax filing will be rolled out and what feedback there has been from the first phase.

Mrs Chu advised that the e-corporate tax filing system had been in place for less than a year. The IRD had received about 700 electronic profits tax returns since 1 April 2010. There was no particular feedback from the users. Taking this opportunity, the IRD would like to appeal to the Institute to encourage its members to make more use of the electronic filing system. Any feedbacks were also welcomed.

Mrs Chu pointed out that the IRD would undertake a massive system infrastructure enhancement project in the coming few years. The IRD had no definite plan for the next phase of e-filing for profits tax return for the time being.

Ms Macpherson said the major obstacle that prevented tax representatives from using the electronic filing system was that a tax representative was not allowed to use its own log-in ID to submit the tax returns on behalf of its clients. Mrs Chu replied that it would not be possible to cater for submission of tax returns in this manner without changing the law.

(f) Time required for reviewing taxpayer's tax returns

Following the judicial review case Yue Yuen Marketing Company Ltd & Ors v CIR, the Institute would like to seek the IRD's view on what would be considered a "reasonable" time for determining an objection. On a related matter, the Institute would like to suggest that the IRD consider including in its performance pledges the standard/ target time for responding to taxpayers' replies to the IRD's enquiries and for settling disputes.

CIR advised that what was a reasonable time for determining an objection by the Commissioner must be considered in the light of all the circumstances: see *Nina T.H. Wang v. CIR* (1994) 4 HKTC 15 at p. 24 and the *Yue Yuen* judgment itself at para. 48 [HCAL 49/2009]. It was thus impracticable to set down rigid rules for ascertaining what constituted a reasonable time in all possible cases. While the IRD always aimed at processing objections in an efficient and effective manner, this could only be achieved with the cooperation of the taxpayer and his/her representative in providing any further information requested by the Assessor. At present, the IRD's performance pledge already covered replies to notices of objection and processing of objections.

(g) Block extension for filing salaries tax returns

The Institute would like to ask if the IRD would consider one of the following options in order to ease the administrative burden of processing monthly extension request for filing salaries tax returns:

(i) Extended block extension – The current block extension scheme extends the time to July 2 for filing forms BIR60. A longer period of time to file the returns would mitigate the need to process additional extension requests.

Mr Wong advised that at the time of completion of his Individuals Tax Return, the taxpayer should have received one copy of the employer's return of remuneration and pensions. Therefore, completion of the Individuals Tax Return, which only involved salaries tax matters, should be relatively simple and straightforward. As a result, it had always been the policy of the IRD not to grant a long period of extension. For represented cases not involving sole proprietorship business accounts, a block extension would be granted to end of June or early July. For those involving sole proprietorship business accounts (irrespective of accounting date), extension would be granted to end of September or early October. The IRD wished to state that it did not have much room to manoeuvre as any further extension would have adverse impact on its assessment and collection programme.

(ii) Subsequent block extension – Currently a single block extension request can be filed by tax practitioners. Further extensions have to be filed individually. A second block extension would mitigate the number of individual extension requests to be processed.

Mr Wong advised that unless there were exceptional circumstances e.g. the taxpayer was in serious illness, no further extension would be allowed. Requests for further extension for filing an Individuals Tax Return would be considered on a case by case basis. A subsequent block extension would not be acceded to.

(iii) Individual extension for multiple months – Currently an individual extension request is generally limited to 30 days. Extending the period of time covered by such an extension request would mitigate the number of extension requests that have to be processed by the IRD.

Mr Wong advised that since it had not been the intention of the IRD to grant a long extension of time for filing an Individuals Tax Return, requests for an extension of time which exceeded 30 days would not be considered.

(h) Filing of employer's returns

It is understood that an employer has to file an IR56B annually for its employees. This includes employees working outside Hong Kong. In addition, the IRO also requires an employer to file an IR56G (and withhold payments) when an employee leaves Hong Kong for more than one month, unless the individual is required in the course of his employment to leave Hong Kong at frequent intervals.

Where an employee is posted overseas and remains an employee of the Hong Kong company, the Institute would like to clarify whether an IR56G (and withholding of payments) is required, or whether an annual IR56B is sufficient. The Institute believes the latter should be sufficient as the individual should be considered as leaving Hong Kong in the course of his employment, but would like to seek the IRD's confirmation of this.

On a related question, if an employee is entitled to treaty benefits under the CDTA between Hong Kong and another jurisdiction, e.g. (a) he is present in Hong Kong for not more than 183 days in any 12-month period, (b) the remuneration is not paid by an employer resident in Hong Kong, and (c) the remuneration is not borne by a permanent establishment which the employer has in Hong Kong, the Institute would like to ask if the employer and employee are required to file employer's return/ individual tax return.

Mr Chiu advised that in the first case, if the employee posted overseas remained an employee of an employer in Hong Kong, an annual IR56B had to be filed, and this alone would be sufficient.

Mr Chiu explained that in the second case, the employer and the employee were required to file the employer's return/Individuals Tax Return respectively. The employer's return was required because the employer was not in a position to ascertain whether the employee was really exempt from Hong Kong tax, e.g. the employee might be regarded as a Hong Kong resident by the Hong Kong Competent Authority under the terms of the relevant CDTA. The Individuals Tax Return was required because of the same reason. In addition, where the employee wanted to make a claim for a tax credit under section 50(9), he would have to do so on the Individuals Tax Return for the relevant year of assessment.

(i) Lodgment of tax returns and filing deadlines for 2010/ 2011

The Institute would be interested to know the latest statistics on the filing of tax returns and the filing deadlines for 2010/ 2011.

Ms Lee point out that as shown in Table 1, the IRD issued more returns in the 2009/10 bulk issue exercise than in the previous years. Table 2 showed the filing position for the files under different accounting codes. Table 3 showed the progressive filing results. The overall performance was disappointing. Compared with 2008/09, the lodgement rates for both "M" code and "D" code returns by the respective deadlines dropped. Tax representatives were urged to improve their performance. Table 4 was a comparative analysis of compliance with the block extension scheme.

Bulk Issue of 2010/11 Profits Tax Returns

Ms Lee advised that the bulk issue of 2010/11 Profits Tax Returns for "active" files would be made on 1 April 2011. The extended due dates for filing 2010/11 Profits Tax Returns would be:

Accounting Date Code	Extended Due Date	Further Extended Due Date if opting for e-filing
"N" code	3 May 2011 (no extension)	17 May 2011
"D" code	15 August 2011	29 August 2011
"M" code	15 November 2011	29 November 2011
"M" code – current year loss cases	31 January 2012	31 January 2012