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

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Annual Meeting

The Inland Revenue Department

and

The Hong Kong Institute of Certified Public Accountants

2012

ANNUAL MEETING BETWEEN 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 February 2012.

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

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The 2011/12 annual meeting between the Hong Kong Institute of Certified Public Accountants and the Inland Revenue Department was held on 17 February 2012 at the Inland Revenue Department.

In Attendance

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

Mrs Ayesha M. Lau	Chairperson, Taxation Committee
Ms Florence Chan	Deputy Chairperson, Taxation Committee
Ms Alice Lam	Member, Taxation Committee
Ms Sandra Leung	Member, Taxation Committee
Mr K K So	Member, Taxation Committee
Mr Anthony Tam	Member, Taxation Committee
Mr Peter Tisman	Director, Specialist Practices
Ms Elena Chai	Associate Director, Specialist Practices

Inland Revenue Department ("IRD")

Mr Chu Yam-yuen	Commissioner of Inland Revenue
Mr Wong Kuen-fai	Deputy Commissioner of Inland Revenue (Technical)
Mrs Teresa Chu	Deputy Commissioner of Inland Revenue (Operations)
Ms Doris Lee	Assistant Commissioner of Inland Revenue
Mr Chiu Kwok-kit	Assistant Commissioner of Inland Revenue
Mrs Lai Chi Lai-ming	Assistant Commissioner of Inland Revenue
Miss Ng Yuk-chun	Chief Assessor (Tax Treaty)
Mr Wong Kai-cheong	Senior Assessor (Research)

Mr Chu Yam-yuen (CIR) welcomed the representatives from the Institute to the meeting. Mrs Lau thanked the IRD for arranging the annual meeting and the support given by the IRD to the Institute's key events during the past year. The Institute considered that the issues discussed during the annual meeting were very useful to tax practitioners as well as the business community in general.

PART A - MATTERS RAISED BY THE INSTITUTE

Agenda item A1 - Profits tax issues

(a) Source of profits when unlisted shares subsequently become listed or vice versa

Departmental Interpretation and Practice Notes (DIPN) No. 21 (Revised) states that the source of profits from the purchase and sale of listed shares and other securities is generally determined by the location of the stock exchange where the shares or securities in question are traded. For unlisted shares and other securities (or listed shares or securities not traded through a stock exchange), the source of profits is generally determined by the place where the contracts of purchase and sale are "effected".

The Institute would like the Inland Revenue Department (IRD) to advise whether it would accept that when either the contract of purchase or sale is effected through a stock exchange (e.g. when unlisted shares become subsequently listed or vice versa), the source of the relevant profits would be determined by the location of the relevant stock exchange. If not, the Institute would like to know what the source rule for this type of situation would be.

CIR advised that a similar question was raised and answered at the 2008 annual meeting. He referred to paragraphs A1(i)(ii)(a)&(b) of the 2008 minutes and said that the answer remained correct and relevant. The source of profit was a question of fact depending on the nature of the transaction. The place of listing was a simple test to decide the source of profits from listed share transactions. Where there was a change in the listing of the shares after the purchase and before sale, i.e. from unlisted shares to listed shares or vice versa, it was not appropriate to apply this simple test indiscriminately. The IRD would take into account the actual operations of the taxpayer that generated the profits in question in determining the source of profits. The place of listing was one of the factors that the IRD would take into account. CIR concluded that, in general, where either the contract of purchase or contract of sale was effected in Hong Kong, the initial presumption would be that the profits are fully taxable (paragraph 23(c) of DIPN 21).

(b) Source of interest income derived from second-hand loans

In the 2008 annual meeting between the IRD and the Institute, the IRD expressed the view that the source of interest income derived from bonds purchased from the secondary market is the place where the initial funds were received by the issuer and any subsequent transactions in the bonds would not alter the source of the interest income, which has been fixed by the initial offering. Similar situation may occur for loans. For example, a Hong Kong company (Company X) provided a loan to an overseas group company (Company Y) and the provision of credit of such loan was outside Hong Kong. The loan was subsequently transferred/ sold to another Hong Kong company (Company Z) in Hong Kong.

The Institute would like to know whether the principle for determining the source of interest income derived from secondary purchase of bonds also applies to interest income derived from second-hand loans (e.g. loan purchased/ transferred from the initial lender). Taking the above example, would the IRD consider that the source of interest income derived by Company Z from the loan acquired from Company X is the place where the loan was first made available to Company Y by Company X, which is outside Hong Kong.

CIR explained that the source of profit was a question of fact. Generally speaking, interest on a loan was compensation for money lent. The interest arose in or was derived from the place where the credit was provided to the borrower - the provision of credit test. In the example above, the IRD would in general accept that the source of interest income derived by Company Z from Company Y was outside Hong Kong. But where the business of Company Z was the borrowing and lending of money or other financing business, the interest income from Company Y would form part of the profits of its business. In such circumstance, the operations test was more relevant in determining the source of profit, i.e. one looked to see what the taxpayer had done to earn the profit in question and where he had done it.

(c) Determination of location of provision of credit in loan transactions without cash movement

The Institute would like the IRD to advise on how the location of provision of credit is to be determined in the following example.

Company X has borrowed a loan (Loan 1) from Creditor A. Instead of Company X repaying Loan 1 to Creditor A, Loan 1 is settled and replaced by a new loan between Company Y and Creditor A (Loan 2) and at the same time, another new loan is created between Company X and Company Y (Loan 3). There is no cash movement in respect of all these loan transactions. Assuming that both Loan 2 and Loan 3 are interest bearing, we would like to seek the IRD's view on how the location of provision of credit is to be determined for Loan 2 and Loan 3.

CIR remarked that first of all, the IRD should not be expected to answer any questions regarding hypothetical situation nor comment on any specific case. Taxpayers should make use of the IRD's advance ruling system where appropriate.

CIR advised that in determining the source of interest income of a simple loan arrangement for a company not carrying on the business of a financial institution, the test generally applied was the provision of credit test. Whether the provision of a loan constituted a simple loan arrangement was a question of fact. Where the loans were not simple loans of money, the proper test to be applied was the operations test rather than the provision of credit test. In cases involving the more complex operations of the borrowing and lending of money, the operations test applied.

CIR added that the example given by the Institute was far removed from the simple type of loan transaction, and may even raise the question whether a real loan was involved. This was because there was no fund movement in respect of Loan 2 and Loan 3, and Company Y was in effect indebted to Creditor A in respect of a sum previously lent to Company X. Besides, the legal effect and consequences of the new "loan" arrangements were not clear. Hence, the IRD considered that it would not be appropriate to apply the provision of credit test in this case. The source of interest was a question of fact and the IRD would take into account all relevant facts, including the nature of business carried on by the parties involved, how the transactions were in fact carried out, and the contractual terms of the loans.

(d) Source of royalty income

As part of the communication between the Administration and the Bills Committee on the Inland Revenue (Amendment) (No.2) Bill 2011 (the Bill), the Administration provided in Council Paper CB(1)2447/10-11(01) dated 10 June 2011 (the Paper) its responses to submissions from deputations on the Bill. One of the submissions made by deputations is that the Administration should clarify whether royalties (or licence fees) derived from licensing intellectual property (IP) for use outside Hong Kong are chargeable to tax in Hong Kong. In response, the Administration set out in Annex A (in item 8) three different types of licensing arrangement and explain how the source of royalties is to be determined under each type of arrangement for illustration purpose. The three types of licensing arrangement and the determination of source of royalties can be summarised below:

(i) If an IP is created or developed in Hong Kong by a taxpayer and is licensed by the taxpayer to another party for use outside Hong Kong, the royalties so derived will generally be regarded as Hong Kong sourced income and hence will be subject to Hong Kong tax.

(ii) If a taxpayer has purchased the proprietary interest of an IP and licenses that IP to another party for use outside Hong Kong, the royalties so derived will generally be regarded as non-Hong Kong sourced income and hence will not be subject to Hong Kong tax.

(iii) If a taxpayer has only obtained a licence to use an IP (but not the proprietary interest of the IP) from its owner and then sub-license the IP to another party for use outside Hong Kong, the IRD may take the place of acquisition and granting of licence for use of the IP as the source of the royalties so derived.

The current version of DIPN 21 (Revised) covers only (in paragraph 45) the determination of source of royalties under the licensing and sub-licensing arrangement (i.e. scenario (iii) above). The Institute would like to ask whether the IRD would consider incorporating the views expressed by the Administration in determining the source of royalties under the other two types of arrangement (i.e. scenarios (i) and (ii) above) in DIPN 21 (Revised) so as to provide greater certainty and clarity to taxpayers.

In addition, the Administration indicated in the Paper that under scenario (i) above, the expenses incurred in creating or developing the IP will be deductible under section 16B if such expenses are related to research and development. Therefore, for the purpose of clarity, the Institute would like to enquire if the IRD could state the same view in Part A on "research and development" in DIPN 5 (Revised).

Mr Wong Kuen-fai (Mr Wong) advised that the IRD was drafting a DIPN on the deduction of capital expenditure on the acquisition of intellectual property rights, introduced by the Inland Revenue (Amendment) (No. 3) Ordinance. The DIPN would cover the three scenarios on the source of royalty payments as well as the deduction of research and development expenditure mentioned in the Administration's replies to the Bills Committee.

In reply to Mrs Lau, Mr Wong said the new DIPN would include all the examples and scenarios, and cross-references to the existing DIPNs would be given to facilitate readers. Amendments to existing DIPNs, such as DIPN 5, where needed, would be dealt with at the same time.

[Post meeting note: DIPN 49 has been issued in July 2012 to address the above issues.]

(e) Meaning of "use in Hong Kong" for the purpose of sections 15(1)(a) & (b)

Sections 15(1)(a) & (b) deem the sums, not otherwise chargeable to tax under section 14, received by or accrued to a non-resident for the use of or right to use in Hong Kong certain IP, as taxable trading receipts. In this regard, a non-resident who is the owner of an IP may receive royalties from allowing a sub-licensor in Hong Kong to sub-license the IP for use outside Hong Kong only. Under the arrangement, the non-resident grants only a right to the Hong Kong sub-licensor to sub-license the IP for use outside Hong Kong. The relevant IP cannot be used by the sub-licensor or any other person in Hong Kong.

The Institute would like to seek the IRD's confirmation that in the above scenario, the IP would not be considered as being used in Hong Kong for the purpose of section 15(1)(a) or (b) and therefore, section 15(1)(a) or (b) does not apply to deem the royalties received by the non-resident as taxable trading receipts, even though the IP is licensed to a person in Hong Kong.

Mr Wong explained that the word “use” was not defined under the Inland Revenue Ordinance (IRO). The term had a wide meaning. Whether the royalties paid by the Hong Kong licensee to the non-resident would be taxable under section 15(1)(a) or (b) depended amongst other things on the IP concerned and terms of the licence agreement. Even if the royalties did not fall within section 15(1)(a) or (b), they were most likely caught by section 15(1)(ba) because the royalties paid by the Hong Kong licencee to the non-resident were deductible in ascertaining its assessable profits.

Mrs Lau noted that, section 15(1)(ba) should have no application if the Hong Kong sub-licensor was merely sub-licensing the IP to a sub-licensee who was an offshore entity, and no deduction for royalties paid was claimed for deduction by the Hong Kong sub-licensor. Ms Chan shared the view that if the whole transaction was arranged offshore, the royalty income received by the Hong Kong sub-licensor would not be taxable and therefore section 15(1)(ba) should not be applicable. Mr Wong remarked that since the Hong Kong sub-licensor was not the owner of the IP, the crux of the matter was whether the royalty income received by the Hong Kong sub-licensor was taxable in Hong Kong. If the royalty income was taxable in Hong Kong, then the Hong Kong sub-licensor could have claimed deduction of the royalties paid and section 15(1)(ba) would come to play.

(f) Expenditure on building refurbishment

The following example is used to illustrate an issue on section 16F "Expenditure on building refurbishment":

Company B incurred capital expenditure (Amount X) in Year 1 on leasehold improvement to its office acquired. It has been claiming commercial building annual allowances for Year 1 and Year 2 where Company B used the office for business purpose and produced assessable profits chargeable to profits tax in Hong Kong.

In Year 3, Company B incurred capital expenditure (Amount Y) on refurbishment of its office and such capital expenditure qualified for a deduction in accordance with section 16F, i.e., one-fifth of the expenditure in the basis period in which the expenditure was actually incurred and the remaining part is to be allowed by 4 equal deductions, one in each of the basis periods for the next succeeding 4 years of assessment.

In Year 4, Company B ceased its business operations. In the cessation return, Company B is eligible to obtain balancing allowance with regard to Amount X under section 35(1)(a)(iii).

In light of the intention of section 16F is to provide relief to taxpayers, the Institute would like the IRD to confirm that Company B would be able to obtain a similar tax treatment under section 35(1) above, with regard to any unclaimed amount of Amount Y.

Mrs Chu advised that the simple answer was “No”.

Mrs Chu explained that section 16F was introduced in 1996 to enable hotels to amortise capital expenditure on refurbishment over a 5-year period in five equal instalments. It was recognised that, for a hotel, renovation was required from time to time to maintain quality and standards. In 1998, the scope of section 16F was extended to cover capital expenditure on the refurbishments of all non-domestic buildings.

Section 16F(3) provided that a taxpayer who claimed a deduction under this provision was not entitled to claim the allowances under Part VI in respect of the same expenditure. Therefore, section 35(1) contained in Part VI, was not applicable to an expenditure claimed under section 16F.

If the property in respect of which capital expenditure meeting the requirements under section 16F was sold before the five equal instalments were fully granted, section 16F(2) would nonetheless allow deduction to the person of the remaining instalments over the succeeding years of assessment as if the property had not yet been sold (see paragraph 42 of DIPN 5). However this was not applicable where there was a cessation of business.

(g) Transfer pricing methodology

Paragraph 68 of DIPN 46 "Transfer Pricing Guidelines – Methodologies and Related Issues" indicates that traditional transaction methods are the most direct means of establishing whether conditions in the commercial and financial relations between associated enterprises are arm's length. As a result, where, taking account of the comparability analysis of the controlled transaction under review and of the availability of information, a traditional transaction method and a transactional profit method can be applied in an equally reliable manner, the traditional transactional method (e.g., CUP method; resale price method and cost plus method) is preferred to the transactional profit method (e.g., the profit-split method and the transactional net margin method).

We note, however, that, under the OECD's Transfer Pricing Guidelines of 2010, transfer pricing methods would be given equal footing, and would like the IRD to advise whether it will consider revising DIPN 46 and aligning it with the OECD's Transfer Pricing Guidelines in this respect.

Mrs Lai explained that in the selection of the most appropriate transfer pricing method, DIPN46 conformed to the OECD guidance at paragraphs 2.2 and 2.3, pages 59-60, of its Transfer Pricing Guidelines released in July 2010, which read as follows:-

"*2.2 The selection of a transfer pricing method always aims at finding the most appropriate method for a particular case. …*

2.3 Traditional transaction methods are regarded as the most direct means of establishing whether conditions in the commercial and financial relations between associated enterprises are arm's length. This is because any difference in the price of a controlled transaction from the price in a comparable uncontrolled transaction can normally be traced directly to the commercial and financial relations made or imposed between the enterprises, and the arm's length conditions can be established by directly substituting the price in the comparable uncontrolled transaction for the price of the controlled transaction. As a result, where, taking account of the criteria described at paragraph 2.2, a traditional transaction method and a transactional profit method can be applied in an equally reliable manner, the traditional transaction method is preferable to the transactional profit method. …"

Mr Tam asked, according to the latest version of the OECD guidelines, in selecting the most appropriate transfer pricing method, whether it was acceptable that a method was chosen without the need to justify the exclusion of the others. Mrs Lai said it must be considered in light of the facts of each case. CIR added that in support of the most appropriate transfer pricing method, although a detailed evaluation or justification would not be required for other methods, the IRD should nonetheless be provided with the reasons behind the selection of methods. It would not be sufficient to favour a particular method without providing any explanations for exclusion of the others.

(h) Transfer pricing adjustments between group companies

Paragraph 11 of DIPN 46 states that "the existence of a double taxation agreement (DTA) however is not a prerequisite for making transfer pricing adjustments. Where the circumstances warrant, adjustments will be made to transactions, domestic or otherwise, under the provisions of the Inland Revenue Ordinance."

For a domestic-to-domestic transaction between two Hong Kong group companies, if a transfer pricing adjustment is made by the assessor on a group company (Company X) claiming the expense deduction (i.e. reducing the amount of expense deductible for tax purposes), would the assessor in charge of the other group company receiving the income (Company Y) make a corresponding/ compensating adjustment (i.e. reducing the amount of income taxable) such that there would be no "double taxation", also taking into account the principle of tax symmetry? Are there any specific arrangements for internal communication between the two assessors in such cases, so that the assessor in charge of Company Y would be informed of the adjustment made to Company X and consider if a corresponding/ compensating adjustment would be warranted, without the taxpayer having to request this?

Mrs Lai advised that where the Assessor made an adjustment on a group company by invoking provisions in the IRO, the other group company affected may apply to have an adjustment on its profits if there was an applicable provision in the IRO that allowed it to do so, for example, if the assessment on the latter group company was still under a valid objection. However, there was no provision or mechanism under the IRO for automatic corresponding or compensating adjustment.

Mrs Lai further explained that the fact that a payment was deductible by the payer did not mean that the payment must be taxable in the hands of the recipient. Equally, the fact that a payment was not deductible or not fully deductible by the payer did not mean that the payment or the non-deductible part of it must be tax free in the hands of the recipient.

Ms Chan said while she agreed with the IRD's technical analysis, she was concerned with the undue hardship suffered by taxpayers if they were denied corresponding adjustments on one side, while being taxed by the transfer pricing adjustments on the other side. Mr Tam added that there were always debates on whether or not transfer pricing adjustments should be recognised as accounting errors such that taxpayers would be able to claim for adjustments for tax purposes. In response to the explanation given by Mr Wong that transfer pricing adjustments were originated by tax authorities, instead of by taxpayers themselves, Ms Lam asked if it was possible to accept corresponding/compensating adjustment arising out of a transfer pricing adjustment as a valid application for revised assessment under section 70A even though no accounting error was found. The IRD was of the view that neither hardship nor corresponding adjustment was a valid ground to revise the assessment under section 70A. However, CIR indicated that the IRD would give more thought to other possible ways of relieving hardship.

Agenda item A2 - Salaries tax issues

(a) Location of employment – residence of employer

DIPN 10 (Revised) states that, in determining the locality of employment, the IRD will take into account all relevant facts, with particular emphasis on:

(i) where the contract was negotiated and entered into and is enforceable, whether in Hong Kong or outside Hong Kong;

(ii) where the employer is resident, whether in Hong Kong or outside Hong Kong; and

(iii) where the employee's remuneration is paid to him, whether in Hong Kong or outside Hong Kong.

In determining the residence of an employer, the IRD will broadly take into account the place where the central management and control of company is located. Particular emphasis is placed on the location where the directors hold the board meetings to run the business.

Practitioners note that in the situation where an employee is employed by an overseas branch of a company incorporated in Hong Kong, the IRD takes the view that the branch is no more than an extension of the company and, therefore, the residence of the employer follows the company. However, in the situation where an employee is employed by a Hong Kong branch of a company incorporated overseas, the IRD takes the view that the residence of the employer is also located in Hong Kong.

Given these inconsistent approaches, the Institute would like the IRD to clarify its position on how it will determine the residence of the employer where an employee is employed by a branch.

Mr Chiu said the question over-simplified the law in this area. There may also be a misunderstanding of the law.

Mr Chiu advised that the IRD accepted that the branch was no more than an extension of the company. Thus the residence of the employer followed that of the company. The IRD would not take the view that the residence of the employer was located in Hong Kong merely because the company incorporated overseas had a branch in Hong Kong.

As a matter of law, a company resided where its real business was carried on and the real business was carried on where its central management and control actually abided. Since it was a question of fact, factors which together were decisive in one instance may individually carry little weight in another. In *Charter View Holdings (BVI) Ltd. v. Corona Investments Ltd. & Another*, [1998] 1 HKLRD 469, Keith J said that all the circumstances in which the company carried on its business should be taken into account.

Normally, the IRD would attach importance to the place where the company's board of directors met to run the business of the company. But the location of board meetings was not necessarily conclusive. The place of directors' meetings was significant only if those meetings constitute the medium through which central management and control was exercised.

Mr Chiu further explained that the IRD would take the view that the residence of the employer was located in Hong Kong if the business of the company incorporated overseas was centrally managed and controlled in Hong Kong. In such a case, the company incorporated overseas and having a branch in Hong Kong would not be regarded as resident outside Hong Kong merely because the nominee directors held formal meetings overseas. For example, a company incorporated in the British Virgin Islands and having a branch in Hong Kong was regarded as resident in Hong Kong if the company was owned and run by individuals resident in Hong Kong.

Generally, where doubts arose about a particular company's residence status, Mr Chiu said the IRD would adopt the following approach: (i) whether the directors in fact exercised central management and control; (ii) where the directors exercised this central management and control (which was not necessarily where they met); and (iii) where the directors apparently did not exercise central management and control of the company, where and by whom it was exercised.

Mrs Lau considered that the detailed analysis given by the IRD would help to confirm and clarify the determining factor for the residence status of an employer. In agreeing with Ms Chan that there was sometimes misconception between the residence of an employer and that of the employment, Mr Chiu commented that even though an employer was not resident in Hong Kong, it did not necessarily mean that the employment would not constitute a Hong Kong employment if the employment contract was concluded and executed in Hong Kong and that the payments were made in Hong Kong.

(b) Factor(s) determining the source of directors' fees

The Institute understands the key factor that determines the source of directors' fees paid by companies for Hong Kong salaries tax purposes is the central management and control of the fee paying company. However the Institute is aware of a situation where the assessor did not follow the above principle and considered that the location of the stock exchange where a fee paying company's shares were listed (e.g. H share companies) helped determine the source of the directors' fees. The Institute would like the IRD to confirm that the source of directors' fees for salaries tax purposes continues to be based on the central management of control of the company paying the directors' fees.

Mr Chiu advised that generally, the location of the office of director of a company was determined by where the company was resident. The residence of a company was located in the place where the central management and control of the company was exercised.

If the office of director was located in Hong Kong, any fees derived from the office should properly arose in Hong Kong. This issue was before the Board of Review in Case No. D123/02, 18 IRBRD 150 in which the Board found that the office of director held by the taxpayer was located in Hong Kong because the superior and directing authority of the company was exercised in Hong Kong.

Mr Chiu commented that the location of the stock exchange where a fee paying company's shares were listed (e.g. H share companies) should not be conclusive in determining the source of the directors' fees. The IRD confirmed that the source of directors' fees for salaries tax purposes continued to be based on the central management and control of the company paying the directors' fees. However, the IRD would like to emphasize that the place of central management and control of a company was a question of fact which required a critical analysis of the factual circumstances. The answer to question A2(a) relating to the place of residence of a company was equally relevant here.

Mrs Lau considered that it would be useful for the IRD's confirmation that the location of listing should not of itself be conclusive in determining the source of directors' fees although it could be taken into account in assisting to determine the central management and control of a company. She agreed that the test still remained the place where the central management and control was exercised.

(c) Taxation of directors' fees where the individual has to on-pay the fees to his employer

The following example is used to illustrate an issue on taxation on directors' fee:

Company D is an overseas company in Country Z with neither presence nor business activities in Hong Kong. It appoints an individual, Mr E from Country Z to sit on the board of its Hong Kong investee company (HKCo).

Mr E does not come to Hong Kong. He attends directors' meetings of the HKCo via tele- or video-conference facilities. HKCo pays directors' fees to Mr E and reports the same in form IR 56B.

Under an agreement between Company D and Mr E, all directors' fees received by him have to be on-paid to Company D and there are documents to support the same.

The Institute would like the IRD to:

(i) confirm that Mr E is not taxable on the fees as the directors' fees are not his income (in substance), but the income of Company D;

(ii) where the IRD considers Mr E is taxable on the directors' fees, as he is legally the director of HKCo, advise whether the on-payment made to Company D is deductible in computing his salaries tax liability;

(iii) advise whether Company D would be subject to salaries tax in Hong Kong on the directors' fees under section 8(1)(a) and, if so, whether personal allowances will be available; and

(iv) advise what the answer to (iii) would be if Company D is the corporate director of HKCo receiving directors' fees but not performing any services in Hong Kong.

Mr Chiu advised that if an individual was appointed as the director of a company resident in Hong Kong, the director's fees accruing to the individual would be charged to Hong Kong salaries tax. Thus, fees received in respect of directorships held by members of a professional partnership were strictly speaking assessable on the individual partners under salaries tax. However, the IRD would accede to a request from the partnership for the inclusion of the fees under profits tax provided that: (i) the directorship was a normal incident of the profession and of the particular practice concerned; (ii) the fees were only a small part of the profits; and (iii) the fees were pooled for division among the partners under the partnership agreement or according to the partners' mutual understanding. In such a case, the partnership seeking such treatment was expected to provide the IRD with a written undertaking that the directors' fees received would be offered for assessment under profits tax in full.

If a company had the right to appoint a director to the board of another company, by virtue of its shareholdings in, or a formal agreement with, the second company then, provided the director was required to hand over to the first company any fees or other remuneration received in respect of his directorship with the second company and actually did so, and the first company was chargeable to profits tax under section 14 and agreed to accept profits tax liability on the fees, those fees were treated as profits of the first company and not of the director.

Subject to the above comments, the IRD would reply as follows: (i) Mr E was taxable on the directors' fees as the fees were his income legally; (ii) the on-payment made to Company D was not deductible under section 12 in computing Mr E's salaries tax liability; (iii) and (iv) the IRD did not have a court case to test the water at present.

Mrs Lau asked why there appeared to be an inconsistency between the answers to questions (i) and (ii). Mr Chiu explained that (i) could be a case of, for example, a law firm which might be required to sit on the board of a client, whereas (ii) was more like the situation of a parent /subsidiary relationship, where the person concerned was the representative nominated to sit the board. In the case of (ii), the individual would not be taxed.

(d) Practice in relation to section 8(1A)(b) read in conjunction with section 8(1B)

DIPN 10 (Revised) sets out that, where an employee deriving income from a Hong Kong employment is posted overseas and renders all his services outside Hong Kong, his income will be wholly exempt. In addition, services rendered during visits to Hong Kong that total no more than 60 days are ignored. However, if he visits Hong Kong for 61 days or more, the whole of his income will be chargeable to tax. In counting the number of days, no account is currently taken of the nature of the employee's visits, i.e. whether they are for business or personal reasons.

The Institute would like to ask if the IRD would consider allowing a full exemption claim where the 60 days of physical presence in Hong Kong was exceeded due to circumstances beyond the control of the employee e.g., hospitalisation.

CIR advised that when counting the days of physical presence in Hong Kong, the IRD did not consider that it had any discretion to exclude the days the employee stays in Hong Kong because of circumstances beyond his control. Days of hospitalisation in Hong Kong would be included. Since the issue had been decided by the Board of Review, CIR concluded that there could not be any concession.

Agenda item A3 - Cross-border tax issues

(a) Double taxation on option income

The following example is used to illustrate an issue of double taxation on option income received by a Hong Kong resident individual:

Mr. C is a Hong Kong resident person. He was having a Hong Kong employment with his employer. He was sent to mainland China on foreign assignment. He received stock option benefits from his employer but the corresponding stock option costs are borne by an entity in the mainland.

For the mainland individual income tax purposes, Mr. C's option income is fully taxable in the mainland. For Hong Kong salaries tax purposes, since he was holding a Hong Kong employment, his assessable income (including the share related income) is wholly taxable (assuming he could not meet the 60 day exemption rule), subject to exclusion under section 8(1A)(c).

Section 8(1A)(c) could only exclude income derived by Mr. C from services rendered by him in the mainland. Hence his option income from services rendered in Hong Kong would be double taxed in both Hong Kong and the mainland.

The Institute would like the IRD to consider granting relief from Hong Kong salaries tax perspective at which the same option income is being assessed in Hong Kong and the mainland.

Mr Chiu explained that since the employment was located in Hong Kong, the full amount of the option income is assessable under section 8(1)(a), subject to the relief provided under section 8(1A)(c) or section 50.

Mr Chiu remarked that it was not appropriate for the IRD to comment on the individual income tax treatment of the option income in the Mainland. However, if there was taxation not in accordance with the provisions of the double taxation arrangement between Hong Kong and the Mainland of China, Mr C may initiate mutual agreement procedure in the Contracting Party of which he was resident. The Competent Authorities would make an endeavour to resolve difficulties and doubts arising from the interpretation or application of the double taxation arrangement. However, to save time and costs, Mr C after taking professional advice, should first consider to apply for an administrative review of the tax assessment issued to him by the Mainland tax authorities.

(b) Discussion with State Administration of Taxation (SAT)

(i) Update on double taxation income

In respect of the issues raised in previous years on double taxation of income (item A3(a) of the 2011 minutes), the Institute would like to ask if the IRD could give an update on the discussions with SAT.

Mr Wong advised that the IRD had discussed the issue of double taxation on employment income (including bonus) with the SAT during the annual meeting in November 2011. Both sides were exploring possible solutions to eliminate the incidence of double taxation. Announcement would be made when agreement was reached.

(ii) Whether a Hong Kong resident partnership or its corporate partners would be eligible for the 5% reduced withholding tax rate for dividends paid by a mainland company

The Institute would like to ask if the IRD could consider raising the following question in its annual meeting with the SAT.

According to Article 10 of the mainland China-Hong Kong DTA, a reduced withholding rate of 5% in mainland China would apply in respect of dividends received by a Hong Kong resident company as beneficial owner from a mainland company in the case the Hong Kong resident company owns directly at least 25% of the mainland company. Furthermore, Article 3 of the DTA defines the term “company” to mean “any body corporate or any entity which is treated as a body corporate for tax purpose”.

In this context, the Institute would like to know whether a Hong Kong resident partnership would be regarded as a company for the purpose of considering its eligibility for the above reduced withholding tax rate.

The question is raised as there is doubt that a Hong Kong resident partnership can be said to be an entity which is treated as a body corporate for Hong Kong tax purposes. There are views that a Hong Kong resident partnership is a fiscally transparent entity since the basis of taxation of the partnership in Hong Kong depends on the personal characteristics of its partners in terms of rates and offsetting of loses etc.

In the case where the Hong Kong resident partnership is not considered a company for the purposes of Article 10 of the DTA, the Institute would like to know whether a Hong Kong resident corporate partner holding more than 25% interest in the wholly owned foreign enterprise through the partnership would then be eligible for the 5% reduced withholding tax in mainland China.

Mr Wong said the IRD considered that it was not appropriate for it to comment on how the partnership or corporate partner would be taxed in the Mainland or raise the matter with the SAT in the annual meeting, unless there was a real case where the Hong Kong resident partnership or corporate partner had established that it had been taxed or was likely to be taxed not in accordance with the Arrangement.

Mrs Lau noted the difference that, while a partnership was treated as a taxable entity in Hong Kong, it was not treated as an entity for tax purpose under the DTA. Mr Tam added that the position of a non-resident partnership might be accepted by the Mainland as an entity treated as a body corporate for tax purpose. CIR responded that a partnership was only regarded as a taxable entity under the laws of Hong Kong, but not the laws of the Mainland. According to Article 1 of the Corporate Income Tax Law ("the CIT Law") of the Mainland, it was specifically provided that the CIT Law would have no application to a sole-proprietorship business or a partnership business. It was a matter of interpretation and application of laws by the Mainland as to whether a Hong Kong partnership would be regarded as an entity for tax purpose.

Agenda item A4 - Double tax agreements

(a) Hong Kong residency status under DTA

The Institute notes that different DTAs have different criteria in determining whether a non-Hong Kong incorporated company (ForeignCo) would be considered a resident of Hong Kong. For example, the "normal management or control" test is applied in the mainland China-Hong Kong DTA whereas the "primary place of management and control" test is applied in the Japan-Hong Kong DTA. Regardless of the residency criteria to be applied, the Institute would like to seek IRD's advice on:

(i) whether a ForeignCo would be considered by IRD to be a resident of Hong Kong if the ForeignCo only fulfils the Hong Kong residency criteria under the relevant DTA for part of the year;

(ii) whether there is a minimum Hong Kong residency period which a ForeignCo must fulfil before the IRD would consider it to be a resident of Hong Kong;

(iii) where a ForeignCo relocates its business activities, previously carried out overseas, to Hong Kong during a year, whether the IRD would take into account the business activities carried out by the ForeignCo before its relocation to Hong Kong in determining whether the ForeignCo fulfils the Hong Kong residency criteria (i.e., being normally managed or controlled/ centrally managed and controlled in Hong Kong or any other appropriate test under the respective DTA).

The question is raised because most of the activities carried out by a ForeignCo before its relocation to Hong Kong are likely to be outside Hong Kong. Members are concerned that a ForeignCo might be denied residency status and hence prevented from enjoying the DTA benefits notwithstanding that it fulfilled the residency criteria after its relocation.

Miss Ng advised the following:

(i) The place where a company is managed / controlled should not be changed every now and then. In cases where a company relocated its management / control from or to Hong Kong during a year and thus only fulfilled the Hong Kong residency criteria under the relevant DTA for part of the year, the IRD would still consider the company to be a resident of Hong Kong in the year of change. However, a remark would be made on the concerned certificate of resident status showing the date on which the company commenced / ceased to be a resident of Hong Kong.

(ii) There was no minimum threshold for residency period which a ForeignCo must fulfill before the IRD would consider it to be a resident of Hong Kong. The IRD would look at the facts of each case in deciding whether a particular company is a resident of Hong Kong.

(iii) The IRD would consider all the relevant facts in determining the resident status of a company after it relocated its business activities to Hong Kong. Whilst the company's activities prior to relocation would not be the determining factor on its resident status, these activities could shed light on whether the company was really managed / controlled in Hong Kong after the relocation.

(b) Permanent establishment

The Institute would like to have the IRD's view on the following situation.

A company incorporated in an overseas jurisdiction, for example, the UK (UK Co) is primarily engaged in trading of goods and has a branch office in Hong Kong (HK Branch) whose activities are limited to:

- Warehousing
- Packaging
- Distribution i.e. delivery of goods
- Quality control

The HK Branch has only one employee, a quality control manager, in Hong Kong. All other activities are outsourced to a third party service provider. Prior to the conclusion of the double taxation agreement between the UK and Hong Kong (the UK-HK DTA), the HK Branch is allocated income based on its cost plus a 10% mark-up.

Under Article 7 of the UK-HK DTA, the profits of a UK resident company is taxable only in the UK (i.e., Hong Kong has no taxing right) unless that company carries on a business in Hong Kong through a permanent establishment (PE) situated therein. In such a case its profits may be taxed in Hong Kong, but only so much of them as is attributable to that PE.

On the premises that HK Branch's activities do not give rise to a PE in Hong Kong for the UK Co under the UK-HK DTA, Hong Kong should not have any taxing rights on the UK Co.

The Institute would like to seek the IRD's confirmation that the service fee income recognised in the HK Branch's profit and loss account would not be subject to Hong Kong profits tax. Alternatively, would the IRD accept that, where the UK Co reimburses the HK Branch only for expenses it incurred on UK Co's behalf, i.e., without any mark-up, no profit would be recognised in the HK Branch's accounts?

Miss Ng said under the HK-UK DTA, if a UK resident had no PE in Hong Kong, he would not be chargeable to Hong Kong profits tax.

Miss Ng advised that whether the HK Branch of the UK Co constituted a PE in Hong Kong was a question of fact and the totality of facts had to be looked at. In the example quoted, important factors would include whether the HK Branch had a fixed place of business in Hong Kong and whether the third party service provider was an independent agent in terms of paragraph 7 of Article 5 of the HK-UK DTA.

In the event that the HK Branch was regarded as a PE in Hong Kong, attribution of profits to the PE would be governed by Article 7 of the DTA. Where the UK Co reimbursed the HK Branch only for expenses it incurred on the UK Co's behalf without any mark-up, the IRD's position was clearly stated in paragraph 12 of DIPN 46. That was, the attribution should observe the arms' length principle.

(c) Rent from the use of movable property

Under section 15(1)(d), sums received by or accrued to a person by way of hire, rental or similar charges for the use of movable property in Hong Kong, are deemed to be receipts arising or derived from Hong Kong from a trade, profession or business in Hong Kong.

Where a DTA is applicable, the mere presence of movable property in Hong Kong may not give rise to a tax liability in Hong Kong.

The Institute would like to seek the IRD's clarification if a person is obliged in such a situation to notify the IRD of its activities in Hong Kong, and indeed, to prepare profits tax returns, where under the terms of the DTA, no profits tax liability arises.

Miss Ng advised that every person chargeable to tax for any year of assessment was required to inform the Commissioner in writing that he was so chargeable and to file profits tax returns. Hence, a person who received payment for the use of movable property in Hong Kong, which was deemed trading receipts arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong, was required to report his chargeability to the IRD in writing and file profits tax return issued to him. If he considered that the receipts should not be assessed to Hong Kong profits tax under a particular DTA, he could lodge a claim for exemption. This application would be subject to verification and acceptance by the IRD.

(d) Procedures for Hong Kong payers to apply a lower withholding rate for royalties under DTAs

Under a number of Hong Kong's DTAs with other jurisdictions (e.g., those with Austria, Ireland, the UK), the withholding tax rate on royalties paid by a Hong Kong taxpayer to residents of the jurisdictions concerned would be reduced from 4.95% (for corporations) or 4.5% (for individuals) to 3%, provided that such residents received the royalties as beneficial owners (assuming that the relevant anti-avoidance provisions contained in the IRO are not triggered). However, the Hong Kong payer may not know whether such recipients qualify as residents of the jurisdictions concerned, or whether they are beneficial owners of the royalties. In this regard, the Institute would like to enquire whether the IRD would issue guidelines as to the amounts and the procedures that the payer should follow when withholding the taxes.

Mr Wong explained that whilst it was appreciated that the payer of royalties may not be in a position to know whether the recipient would qualify as a resident of the jurisdiction concerned and hence entitled to the treaty benefits, it was incumbent upon the recipient, if it intended to enjoy the reduced tax rate provided in that DTA, to inform the payer that it was a resident of that jurisdiction within the meaning of the DTA concerned. In turn, the payer could write to the IRD, with a tax resident certificate issued by the relevant jurisdiction, to confirm whether the claim was acceptable to the IRD. If the IRD accepted the claim, the payer and the recipient would be informed accordingly. The payer could then withhold payment at the reduced tax rate. When the recipient ceased to be a resident of the contracting party, the payer should notify the IRD of the change within 30 days and withheld payment at the normal tax rate as from the date of change. It was the duty of the payer to withhold the correct amount of tax at all times.

In cases where the payer was not certain of the recipient's resident status or where the IRD had not allowed the payer to withhold payment at the reduced tax rate, the payer should deduct the withholding tax at the normal rate as stated in the IRO.

Mr Wong said in any event, when lodging the tax return (BIR54), the payer should provide details of the nature and amount of the sum accrued to or received by the recipient, state the country/territory of which the recipient was a resident and enclosed documentary evidence in support of the resident status of the recipient.

In an example where the IP was not previously owned in Hong Kong, for payments chargeable to tax under section 15(1)(b) or section 15(1)(ba), the assessable profits are calculated to be 30% of the sum pursuant to section 21A, giving an effective tax rate of 4.95%. The profits tax return (BIR 54) and notice of assessment are issued in the name of the Hong Kong payer on behalf of the IP licensor. Where the IP licensor is in a jurisdiction with which Hong Kong has entered into a DTA, a reduced tax rate of 3% may be available for such royalties. Under this situation, the Institute would like to seek the IRD's guidance as to how the IP licensor can claim the reduced rate of tax under the DTA. Specifically,

(i) Whether the Hong Kong payer needs to verify the licensor's eligibility for the reduced rate, and if so, what procedures the Hong Kong payer should follow?

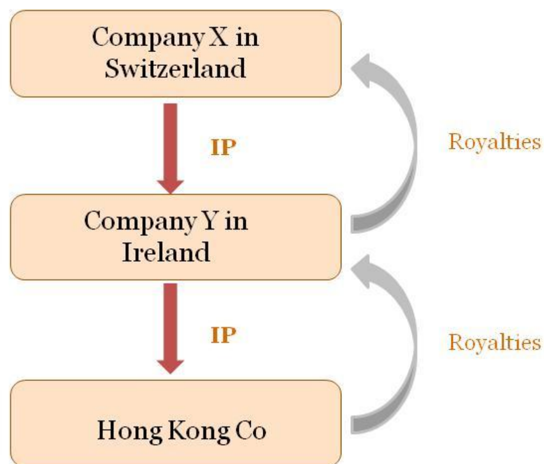
(ii) How would the IRD give effect to the reduced tax liability? It should be noted that the current form BIR 54 does not cater for the reduced rate where a DTA is applicable.

Ms Lee advised that in the new profits tax return (BIR 54), there would be a box on whether the non-resident person wished to claim the lower rate of tax for receipts pursuant to a DTA. If the lower tax rate was claimed, details of the nature and amount of the sum received, the country of which the non-resident person was a resident, together with documentary evidence in support of the resident status were to be provided. For this purpose, the Hong Kong payer would need to ask the licensor for a certificate of resident status issued by the DTA partner.

(e) Beneficial ownership and interaction between treaty provisions and domestic anti-avoidance provisions

The Institute would like to seek the IRD's views on the following case:

An IP originally owned by a Hong Kong company carrying on a business in Hong Kong was transferred to an overseas group company (Company X) located in treaty jurisdiction 1. Company X licenses the IP to another overseas group company (Company Y) in treaty jurisdiction 2 which then licenses the IP back to the Hong Kong company. Royalties are paid by the Hong Kong company to Company Y and then by Company Y to Company X. The arrangement is illustrated in the diagram below using Switzerland as treaty jurisdiction 1 and Ireland as treaty jurisdiction 2 for illustrative purpose.



The IP was originally owned by Hong Kong Co and subsequently transferred to Company X

(i) The Institute would like to ask whether the IRD would consider Company Y in the above example to be the beneficial owner of the royalties received from the Hong Kong company. In addition, what factors would be taken into account by the IRD in its assessment of the beneficial owner status of Company Y?

Mr Wong advised that the IRD would look at the facts and circumstances of each case before deciding on the beneficial ownership of the royalties. It was the IRD's view that "beneficial owner" was the person who actually received the benefit and fully controlled the income. Where the recipient of the income did not actually receive the economic benefit of the income concerned, but only collected it in the capacity of an agent or a nominee and would subsequently transfer the income to the actual owner in accordance with a contract or the law, such an agent or a nominee would not be deemed to be the beneficial owner of the income. This was in line with paragraphs 4 and 4.1 of the OECD Commentary on Article 12. Whether or not the IRD would regard Company Y as the beneficial owner of the royalties received from the Hong Kong company depended on whether Company Y could prove to the satisfaction of the IRD that it had substantive business activities carried on and that its receipt of royalties from the Hong Kong company and the subsequent payment to Company X were bona fide business activities rather than merely acting in the capacity of an agent or a nominee.

(ii) If the IRD considers that Company X (instead of Company Y) is the beneficial owner of the royalties paid by the Hong Kong company, would the reduced withholding rate under the treaty between Hong Kong and Switzerland be applicable to the royalties paid out by the Hong Kong company?

Mr Wong explained that in case where the IRD did not accept Company Y as the beneficial owner, it was for Company X to prove to the satisfaction of the IRD that it was the beneficial owner of the royalties paid by the Hong Kong company. In such circumstances, the reduced tax rate under the agreement between Hong Kong and Switzerland would be applicable to the royalties paid out by the Hong Kong company. This was consistent with paragraph 4.2 of the OECD Commentary on Article 12 that subject to other conditions

imposed by the Article, the limitation of tax in the State of source remained available when an intermediary, such as an agent or nominee, was interposed between the beneficiary and the payer, in those cases where the beneficial owner was a resident of the other Contracting State.

(iii) Assuming Company Y is the beneficial owner of the royalties paid by the Hong Kong company and, given that in the Hong Kong-Ireland treaty there is no specific provision saying each contracting party can apply its domestic laws and measures concerning tax avoidance, does the IRD consider that section 21A(1)(a) could be invoked to override the treaty provisions, such that the 16.5% (instead of 3%) tax rate could be applied on the royalties received by Company Y?

Mr Wong said whilst a specific provision expressly stating that each contracting party was free to use its own anti-avoidance provisions in the domestic laws would put the matter beyond doubt, its absence did not deny the right of each party to apply its own anti-avoidance provisions in the domestic laws. It was clearly stated in paragraph 9.2 of the OECD Commentary on Article 1 that to the extent anti-avoidance rules were part of the basic domestic rules set by domestic tax laws for determining which facts gave rise to a tax liability, they were not addressed in tax treaties and were therefore not affected by them. In other words, domestic anti-avoidance rules not mentioned or addressed in a tax treaty were not affected by the treaty and would hence remain effective. In the instant case, even though there was no specific provision in the Hong Kong-Ireland agreement providing that each contracting party could apply its domestic laws and measures concerning tax avoidance, section 21A(1)(a) could still be invoked notwithstanding the provisions of the agreement. Therefore, the tax rate of 16.5% (instead of 3%) would be applied on the royalties received by Company Y.

(f) Tax credit claim in relation to gains arising from disposal of company

The issue is illustrated by way of the following example. HK Co holds 100% of the issued shares of a BVI company, which in turn holds 100% of the issued shares of a wholly owned foreign enterprise (WOFE) in mainland China. HK Co disposes its entire interest in the BVI company, resulting in a gain. Hong Kong profits tax is payable in respect of such gain as it is found to be revenue in nature and sourced in Hong Kong. However, at the same time the mainland tax bureau, via a reporting requirement under Guoshuihan 2009 No. 698 (Circular 698), invokes the relevant provisions of the corporate income tax law, to tax HK Co as if it had directly disposed of the WOFE, disregarding the intermediate BVI company in the process.

The Institute would like to know whether in the circumstances where capital gains tax has been suffered by HK Co in mainland China (in respect of its deemed disposal of the WOFE), could it be credited against its tax payable in Hong Kong (in respect of its disposal of the BVI company).

Mrs Chu said in the example quoted, the capital gains tax suffered by the HK Co. in the Mainland in respect of its deemed disposal of the WOFE could be credited against its tax payable in Hong Kong in respect of its disposal of the BVI company.

(g) Application of the treaty provisions in the year of assessment where the treaty takes effect

Two of the DTAs signed by Hong Kong (i.e. those with Brunei and the United Kingdom) are effective for any year of assessment beginning on or after 1 April 2011 (i.e. from year of assessment 2011/12). Paragraph 9 of revised DIPN 44 mentions that in respect of the mainland China-Hong Kong DTA which became effective from year of assessment 2007/08, the income derived by a Hong Kong enterprise during the basis period that falls within year of assessment 2007/08 will be dealt with in accordance with the provisions of the arrangement, even though the basis period may commence before 1 April 2007. Hence, the Institute would like to clarify the following:

(i) Based on the above, it is expected that the same principle applies to other DTAs. For example, the Brunei and United Kingdom treaty provisions are applicable to income derived by a Hong Kong enterprise during the basis period that falls within year of assessment 2011/12, even in the case where the basis period of the enterprise commenced before 1 April 2011 (such as those enterprises with an accounting year ended 30 June 2011). In such case, would the income derived during the whole basis period (including that derived from 1 July 2010 to 31 March 2011) be dealt with in accordance with the Brunei and United Kingdom treaty provisions and no apportionment is required?

Miss Ng said the same principle as stated in paragraph 9 of DIPN No. 44 also applied to other DTAs. Thus the income derived during the whole basis period that fell within the commencement year of assessment of the respective DTA would be dealt with in accordance with the provisions of that DTA and no apportionment was required.

(ii) For royalty income derived by a non-resident from Hong Kong, would the above principle for Hong Kong enterprise be applied equally to non-residents or would the treaty provisions be applicable only to income “accrued” to non-residents on or after 1 April 2011?

Miss Ng advised that Hong Kong had only one effective date for all treaty benefits and the effective date was related to the year of assessment rather than the date of payment or accrual of the income. Therefore, the above principle would also apply equally to non-residents receiving royalty income from a Hong Kong enterprise. In other words, the royalty income which was paid or accrued in the basis period that fell within the commencement year of the respective DTA would be dealt with in accordance with the provisions of that DTA and no apportionment was required. Furthermore, as the Hong Kong payer was only the conduit through which the tax was charged, it was the accounting date of the foreign entity, which was the person charged with tax and to enjoy the treaty benefits, that should be taken into account when applying the preferential treaty rate for royalty income.

In reply to Mrs Lau, CIR confirmed that in applying the preferential treaty rate for royalty income, the Hong Kong payer had to find out the accounting date of the foreign entity.

(h) Status of DTA negotiations

On IRD's webpage under the heading of "Double Taxation Relief - Negotiations in Progress", the IRD provides information on "Country / Territory", "Negotiations Scheduled" and "Scheduled Negotiations Completed on (certain dates)".

As such, the current status of a particular DTA negotiation would not be known. For instance, after the completion of the scheduled negotiation, as stated in the third column, the following information that may be of interest to taxpayers, would not be available:

(i) whether another round of negotiations has been or is being scheduled;

(ii) whether any outstanding issues would be expected to be resolved by the two parties through correspondence, without the need for another round of meetings;

(iii) whether the negotiation has already been completed and is merely pending an agreed signing date.

The Institute would like to enquire whether it would be possible for the IRD to add a "General Remarks" column to provide the above, and as much other relevant information as possible, without impinging on the confidentiality of the negotiation process, where applicable.

The Institute would also like the IRD to advise the ratification procedures for a DTA. For example, the Institute notes that the DTA with the United Kingdom was signed in June 2010 and that its ratification procedures were in December 2010. Ratification procedures have not yet been put in place for the DTA with Kuwait, which was signed in May 2010. The Institute would like the IRD to clarify the reasons for the time lag in the DTAs entering into force.

CIR advised that negotiation of a DTA was a bilateral matter involving two jurisdictions. Very often such bilateral negotiations involved uncertainties and the position of the negotiation partners may change during the course of the negotiation. Apart from saying that negotiation was underway, it was not advisable to disclose too many details until the formal conclusion of the DTA. This was to ensure that the negotiation would not be jeopardized and that the public was not confused with transient messages. Also the IRD had to respect the position of some negotiation partners who simply did not wish to have details, or even the mere act of holding, of the negotiation disclosed to the public until formal signing of the DTA. Finally, selective disclosure of information in some cases but not others may arouse unnecessary speculations.

The IRD was aware that taxpayers did have growing interest in DTA development but the IRD had to strike the balance. After deliberation, the IRD considered that the information now posted onto the IRD website was appropriate and no change would be made for the time being.

CIR further explained that a DTA had to undergo ratification procedures before it could become effective. The length of the ratification process would depend on the domestic procedures of the two jurisdictions, as well as any peculiar situations that may arise, for example, a jurisdiction may put the ratification on hold in its election year. In fact, some DTAs signed by some countries were never ratified. As far as Hong Kong was concerned, the ratification process would normally take 6 to 9 months. The only exception was perhaps the DTA with Kuwait. Preparation of the section 49 order for this DTA was previously put on hold pending clarification with the Kuwaiti side on certain provisions of the Agreement. The issue had recently been sorted out and the IRD would proceed to prepare the section 49 order soon.

In reply to a question from Ms Chan regarding the progress of the DTA entered into between Hong Kong and Indonesia, CIR advised that while Hong Kong had already finished the ratification process, Hong Kong was awaiting for the Indonesian side to complete the process. In reply to a question about how, generally, Hong Kong was notified about ratification, Mr Wong said that the practice varied from jurisdiction to jurisdiction. Where it was handled very formally, notification came via the treaty partner's consulate in Hong Kong.

[Post meeting note: The DTA entered into between Hong Kong and Indonesia has become effective on 28 March 2012 and shall have effect in Hong Kong for any year of assessment beginning on or after 1 April 2013.]

(i) Position on standalone tax information exchange agreements

After the release of a peer review report (Phase 1) on Hong Kong by the Global Forum on Transparency and Exchange of Information for Tax Purposes on 26 October 2011, the Institute would like to seek the IRD's view on the current position regarding entering into standalone tax information exchange agreements with other jurisdictions.

CIR advised that the Phase 1 peer review report on Hong Kong, endorsed by the Global Forum in late October, had re-affirmed the efforts of Hong Kong in enhancing tax transparency and concluded that generally Hong Kong had adequate legal and regulatory framework to facilitate effective exchange of information.

However, some recommendations had been made to ensure effective exchange of information in all circumstances. Among these, one significant issue related to Hong Kong's capability to enter into TIEAs.

The international standard required that a jurisdiction should exchange information with all relevant partners, meaning all partners interested in entering into an EoI agreement with the jurisdiction. Both DTAs and TIEAs were equally valid instruments for implementing the international standard but preference for a DTA over TIEA could not be a reason for refusal to enter into an EoI agreement.

Due to our legal constraints, Hong Kong was not in a position to conclude TIEAs which did not provide for double taxation relief, which was a requirement under the existing section 49(1A). But recognizing the development of information exchange in the international arena, CIR had undertaken at the Peer Review Group meeting held in Paris in September 2011 that he would recommend to the Hong Kong legislature to work on the legislative measures needed to enable Hong Kong to enter into TIEAs.

As with all other jurisdictions being assessed, Hong Kong was required to submit to the Global Forum a progress report on its follow-up actions one year after the formal endorsement of the report, i.e., October 2012. Besides, the Phase 2 review on Hong Kong would be conducted in the second half of 2012. No doubt, the progress that Hong Kong had made in relation to TIEAs would greatly affect the final assessment by the Global Forum on Hong Kong's efforts in promoting tax transparency.

Given the time frame for the Phase 2 review, CIR said legislative amendments would have to be worked out to implement the recommendations by the Global Forum in the Phase 1 review.

Agenda item A5 - Departmental policy and administrative matters

(a) Advance rulings

The Institute would like to clarify the following in respect of advance rulings:

(i) Practitioners have come across situations where it is difficult to obtain a ruling on certain transactions with a cross-border element, notwithstanding that in some cases a ruling has been obtained from the overseas tax authority concerned. The Institute would like the IRD to clarify its position about the issuance of advance rulings on transactions with a cross-border element.

> Mr Wong advised that the processing of advance rulings was governed by section 88A and Schedule 10 of the IRO. The IRD's practice was set out in DIPN No.31 (Revised). In general, the IRD needed to fully understand the transaction before giving a ruling as to how the provisions of the IRO would apply to the transaction.
>
> The IRD processed each application in accordance with the relevant statutory provisions and in an impartial and independent manner, whether or not the transaction involved a cross-border element. However, where cross-border elements were involved, the facts of the case were usually more complicated. The IRD often needed to seek further clarification, resulting in additional time to complete processing of the applications.

(ii) It also seems to be difficult to obtain rulings which involve more elaborate Hong Kong profit tax issues. Practitioners have experienced considerable delay in receiving a ruling on such a case even though the taxpayer has provided all the relevant information to the IRD in a timely manner. In this regard, the Institute would like the IRD to clarify its position on rulings for more elaborate issues, and the steps that the taxpayers or their representatives can take to expedite the process. In particular, paragraph 34 of DIPN 31 (Revised) mentions that where an arrangement involves complex issues, the IRD would require additional time to fully consider the request and the applicant would be advised at the earliest possible time when any unusual delay is foreseen. Could the IRD provide some examples of the "complex issues" mentioned in the paragraph? In addition, paragraph 35 mentions that request for processing a ruling request ahead of its regular order would only be considered in exceptional circumstances. Could the IRD provide some examples of situations which are considered as "exceptional circumstances"?

> Mr Wong advised that the IRD's position on the processing of advance ruling applications was stated clearly in (i) above. The IRD officers would always try to deal with advance ruling applications expeditiously and respond to the applications within 6 weeks as far as possible. In processing applications, the IRD officers were duty bound to ensure that they fully understood the transaction and the issues involved, in particular those elaborate ones. The IRD officers had been reminded to adhere to the 6-week time frame set out in paragraph 34 of DIPN 31 (Revised) and to maintain close contact with the taxpayers and their representatives. Also, taxpayers and their representatives could no doubt contact the relevant officers to discuss the progress of the applications upon the expiry of the 6-week time frame. The IRD did not consider it appropriate to specify what would or would not constitute complex issues as it all depended on, amongst other things, the structure of the transactions and the issues that require ruling.

Giving priority to a particular application would affect other applicants. The IRD must act fairly to all. What kind of circumstances could be considered as exceptional depended on the facts and situation of a particular case. It was incumbent on the applicant, who had full knowledge of its own situation, to illustrate why the application justified processing ahead of others.

(b) Whether payers under section 20B also have the obligation to inform the chargeability of the non-residents in Hong Kong

Section 20B provides that payers in respect of certain types of payments made to non-residents are obliged to retain, out of the assets of the non-residents coming into their possession or money payable to the non-residents, a sufficient amount of money to cover the tax liabilities of the non-residents in Hong Kong. Furthermore, the non-residents could also be charged to tax in Hong Kong in the name of the payers, and any amount of taxes so charged can be recoverable from the payers. However, some of our members consider that it is not very clear whether the payers also have the obligation to inform the chargeability of the non-residents in Hong Kong under section 51(2).

While the Institute believes that such payers who are not also agents of the non-residents do not have such an obligation under section 53, the Institute would like to seek the IRD's view on this point. This clarification is relevant, even though the payers may in any case disclose the payments in their own tax returns or other forms, e.g. Form IR56M filed with the IRD. This is because such disclosure, even assuming that it constitutes a notification under section 51(2), would normally fall outside the statutory time limit for informing chargeability under the section.

Mrs Lai said section 20B(2) of the IRO provided that:

"*Where this section applies, the non-resident person is chargeable to tax in respect of the sums described in subsection (1) in the name of any person in Hong Kong who paid or credited those sums to that or any other non-resident person, and the tax so charged shall be recoverable by all means provided in this Ordinance from that person in Hong Kong.*"

Section 51(2) required "every person chargeable to tax for any year of assessment" to notify the Commissioner of its chargeability. As the Hong Kong payer under a section 20B(2) scenario was chargeable to tax in its name on behalf of the non-resident (also see para. 10 of DIPN 17), the Hong Kong payer had an obligation under section 51(2) to inform its chargeability on behalf of the non-resident.

(c) Holdover of provisional profits tax due to reduced withholding rates or tax credit claimed under tax treaty and procedure to claim reduced withholding tax

Non-resident companies deriving Hong Kong source income under section 15(1)(a), (b) or (ba), are subject to profits tax at an effective tax rate of 4.95%, pursuant to section 21A(1)(b). Given that there is a growing number of DTAs, there will be more cases where a non-resident taxpayer can enjoy a preferred withholding tax rate lower than 4.95%, e.g. 3%.

Where the overseas company (in the name of the royalty payer in Hong Kong) is assessed on provisional tax based on the effective withholding rate of 4.95%, but considers that the reduced effective rate is 3%, the Institute would like to know if the IRD would, in practice, allow hold over of the provisional profits tax, even though, strictly speaking, the above situation is not one of the conditions prescribed under section 63J(2).

In another situation, a Hong Kong company may have paid or is expected to pay foreign tax which is creditable against Hong Kong profits tax in the year in which provisional tax has been charged. Where the amount of the credit will reduce the Hong Kong profits tax payable to less than 90% of the profits tax payable in the preceding year, or the amount shown on the provisional tax demand note, although again this is not one of the prescribed conditions under section 63J(2), would the IRD, in practice, allow a hold over claim?

As more and more treaties are entered into by Hong Kong, these questions will affect an increasing number of taxpayers.

Ms Lee advised that the IRD would entertain applications for holding over of payment of provisional profits tax on, and only on, those grounds specified in section 63J(2) of the IRO. Neither the preferred / reduced withholding rate nor the creditable foreign tax mentioned in the question are amongst these grounds.

Section 63H provided that provisional profits tax in respect of any year of assessment would be payable at the standard rate by reference to the amount of assessable profits for the year preceding the year of assessment or the sum of assessable profit estimated by the assessor, as the case may be. In ground (a) in section 63J(2), the reference was to "less than 90% of the assessable profits … or of the estimated sum …", the reference was by no means to the profits tax payable.

Ms Chan raised the issue that, in view of the increasing number of tax treaties entered into by Hong Kong, it was desirable to amend or update the IRO to keep its provisions, like those on the holdover of provisional tax due to the application of a DTA, compatible with such developments, to enable Hong Kong to remain competitive within the international arena. CIR agreed to take note of this point.

(d) Foreign tax credit claim

Section 50(9) specifies that any claim for foreign tax credit (FTC) shall be made no later than 2 years after the end of the relevant year of assessment, whereas section 50(10) states that where the amount of a foreign tax credit given is rendered insufficient by reason of any adjustment of the amount of tax payable either in Hong Kong or elsewhere, a claim for relief can be made no later than 2 years from the time when the relevant adjustments have been made. In short, section 50(9) deals with the situation where a FTC claim has never been made previously while section 50(10) deals with the situation where a FTC claim has been made previously.

As the statutory time limit in section 50(10) is different from that of section 50(9), it would be of assistance to taxpayer if the IRD could clarify its practice on the interpretation of the phrases (1) "the amount of a credit given …" and (2) "by reason of any adjustment" in section 50(10). Does "the amount of a credit previously given" refer to the FTC given in respect of a particular income or all FTCs given in a particular year of assessment? In addition, would "adjustment" cover foreign taxes that ought to have been paid, which were not paid in the first instance, but were paid subsequently?

For example, assuming a Hong Kong company derived two amounts of passive income (i.e. passive income 1 and passive income 2) from mainland China in the year of assessment 2010/11 and the mainland's Corporate Income Tax (CIT) was withheld and paid on passive income 1 but not passive income 2. As a result, a tax credit claim in respect of the mainland CIT paid on passive income 1 was made in the year of assessment 2010/11. Subsequently, say after three years, it is clarified that mainland CIT should also be paid on passive income 2 and the Hong Kong company pays the amount of CIT on passive income 2 accordingly. In such situations, would section 50(10) be applicable to the Hong Kong company, such that it could make a claim for the additional foreign tax credit in respect of the mainland CIT paid on passive income 2 within 2 years from the time the mainland CIT on passive income 2 becomes payable?

Ms Lee advised that any discussion about the interpretation of sections 50(9) and 50(10) of the IRO would only be academic. According to the OECD Commentary on "Timing mismatch" (see OECD 2010 Commentary, paragraph 32.8 at page 316), the OECD Model text on methods for elimination of double taxation required that relief be granted where an item of income **may be taxed** by the State of source in accordance with the provisions of the DTA. It followed that such relief must be provided regardless of when the tax was levied by the State of source. Where States linked the relief of double taxation that they gave under the DTA to what was provided under their domestic laws (as was the case of Hong Kong), OECD considered that these States would be expected to seek other ways (the mutual agreement procedure, for example) to relieve the double taxation which might otherwise arose in cases where the State of source levied tax in an earlier or later year.

The IRD agreed with the spirit of the OECD that double tax relief should always be given whenever possible. Therefore, the taxpayer may bring up the matter to the IRD, in case relief was not available under section 50(9), for consideration of MAP, whereupon relief could be granted notwithstanding the provisions of section 50(9). However, so long as the taxpayer was aware of the likelihood of adjustments being made by other states, he should lodge the application to the IRD as soon as possible.

(e) Electronic filing and issue of e-assessment notice

The Institute requests an update on the status of electronic tax returns. In particular, the Institute would like to know if and when the IRD would consider allowing tax representatives to prepare and submit tax returns on-line, and also to issue online notices of assessment to taxpayers and/ or tax representatives.

Mrs Chu advised that the IRD rolled out electronic services under eTAX by phases. At the initial stages, the IRD concentrated on the provision of comprehensive electronic services for individual taxpayers. The IRD had developed a platform delivering full-fledged e-filing and e-notice services for individual taxpayers. At the current stage, the IRD endeavored to provide electronic filing services to cater for the needs of mainly small and medium size businesses. The IRD rolled out e-filing of profits tax returns for small businesses and companies in April 2010 and started accepting internet filing of employer's notifications (forms IR56E/IR56F/IR56G) in August 2011. In April this year, the IRD would extend the electronic return filing services to cover annual employer's returns (BIR56A and IR56B/IR56M) submitted by businesses with not more than 20 employees.

Mrs Lau pointed out that, currently, the efiling system was not conducive to taxpayers filing through their tax representatives. She asked whether this would be addressed in future. Mrs Chu and Mr Wong explained that, in the longer term, the IRD would extend its eTAX services to larger companies and tax-representatives. However, such services would require legislative amendments and the establishment of a sophisticated authentication infrastructure. Given that the IRD was now fully engaged in a massive system infrastructure enhancement project, which would last another few years, a time table had not yet been set to proceed further at the present stage.

(f) Index for annual meeting questions

Currently, the annual meeting minutes are published on IRD's website in a chronologically order. With the number of minutes growing, it is becoming difficult for readers to search for the topics that they are interested in. The Institute would like to ask if IRD would consider providing a subject index of the questions.

Mrs Chu said according to the arrangement between the IRD and the Institute, the annual meeting minutes were published on the Institute's website with a hyperlink provided to the IRD under the Tax Representatives' Corner. Since the annual meeting minutes were not hosted on the IRD's server, it would not be possible to search the contents of such documents on the IRD's website. Even if the minutes were hosted in the IRD's sever and a subject index was provided, the search results would be voluminous since all documents placed in the IRD's website which met the search strings would be listed.

(g) Lodgement of tax returns and filing deadlines for 2011/2012

The Institute would be interested to know the latest statistics on the filing of tax returns and the filing deadlines for 2011/2012.

Ms Lee advised that the filing pattern this year was far from satisfactory. As shown in Table 1, the IRD issued more returns in the 2010/11 bulk issue exercise than in the previous years. Compared with 2009/10, more returns were not filed by the due dates. Table 2 showed the filing position for the files under different accounting codes. Table 3 showed the progressive filing results. The overall performance was not encouraging. Compared with 2009/10, the lodgement rates for both "M" code and "D" code returns by the respective deadlines dropped to 79%. Ms Lee would urge tax representatives to improve their performance. Table 4 was a comparative analysis of compliance with the block extension scheme.

Bulk Issue of 2011/12 Profits Tax Returns

The bulk issue of 2011/12 Profits Tax Returns for "active" files would be made on 2 April 2012. The extended due dates for filing 2011/12 Profits Tax Returns would be:

Accounting Date Code	Extended Due Date	Further Extended Due Date if opting for e-filing
"N" code	2 May 2012 (no extension)	16 May 2012
"D" code	15 August 2012	29 August 2012
"M" code	15 November 2012	29 November 2012
"M" code (current year loss cases)	31 January 2013	31 January 2013

PART B - MATTERS RAISED BY IRD

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

Mrs Lai explained that Appendix B was compiled to illustrate the specific problem areas detected in corporations with tax audits completed during the year ended 31 December 2011. Comparative figures for the years 2009 and 2010 were included.

Field Audit teams uncovered discrepancies in 287 corporation cases, of which 240 carried clean auditors' reports. The amount of discrepancies detected in the clean report cases account for 84% (2010: 93%) of the total discrepancies detected in the year 2011 and total tax of $503 million was recovered from these cases. Average understatement per clean report case was $13.03 million (2010: $25.7 million) while tax undercharged per clean report case is $2.1 million (2010: $4.2 million).

In 2011, discrepancies resulted mainly from offshore claims, understatement of gross profits and technical adjustments. In the majority of cases, the discrepancies were detected after examining the business ledgers and source documents.

In the year, there were 4 cases where it was considered that their auditors should have detected the irregularities through statutory audits. Discrepancies were found in overstatement of expenses which were material in amount but not supported by any evidence.

Agenda Item B2 – Taxation of Payments in Lieu of Notice

Mr Chiu said in *Fuchs, Walter Alfred Heinz v CIR* [2011] 2 HKC 422, the Court of Final Appeal had clarified that payments in lieu of notice, contractually agreed, should fall within the charging section, i.e. section 8 of the IRO, and be chargeable to salaries tax.

Counsel of Department of Justice also advised that payments in lieu of notice made under the explicit terms of an employment contract are taxable. Counsel further advised that payments in lieu of notice made under section 7 of the Employment Ordinance are taxable because the right to receive a payment in lieu of notice under section 7 of the Employment Ordinance constituted an implied term of the employment contract.

The IRD would follow the judgment of the Court of Final Appeal and charge salaries tax on payments in lieu of notice which accrued to an employee on or after 1 April 2012.

Mrs Lau asked if payments not covered contractually, nor on an explicit term, would escape from the charge to salaries tax. Mr Chiu replied that a non contractual payment did not necessarily mean that it was not taxable. It could well be gratuitous in nature. The test applied remained: whether the payment was an income from employment, or damages arising from a breach of contract. In any event, section 7 of the Employment Ordinance provided that an employer would have an obligation to make a payment in lieu of notice as an alternative for not giving a notice of termination of employment. However, Mr Chiu agreed that the question

whether a payment was taxable or not could only be decided after giving due regard to the facts of each case and that not all sums received on termination of employment were taxable.

Agenda Item B3 – Unilateral Advance Pricing Arrangement

Mr Wong advised that the IRD would roll out an Advance Pricing Arrangement (APA) program in April 2012. A DIPN would be released in March setting out the procedures for applying and processing APA applications. At the present stage, the IRD would process applications for bilateral APA but not unilateral APA. The IRD wished to inform members of the Institute that, due to resources constraints, it would not process application of unilateral APA through the advance ruling mechanism (see paragraph 3(e) of Part I of Schedule 10 to the IRO). In fact, the object and purpose of APA and advance ruling were quite different. In the first place, a bilateral APA would help reduce double taxation but unilateral APA would not. Secondly, an APA involved agreement on factual issues while an advance ruling dealt with legal issues. Thirdly, an APA required constant monitoring as the applicant had to file annual compliance reports to the IRD but an advance ruling did not have such requirement.

Mrs Lau was concerned about limited resources within the IRD which prevented the processing of unilateral APA. In her view, such limitation was undesirable given the fact that there was a need for taxpayers to have certainty in unilateral APA. While she acknowledged the benefits of bilateral APA in the elimination of double taxation, Mrs Lau queried the logic of confining this process to bilateral APA, as bilateral APA could be provided only in the context of a DTA, whereas some key trading partners of Hong Kong had not yet entered into a DTA with Hong Kong. Mr Tisman added that if Hong Kong was to enter into TIEAs in future, this could mean that fewer DTAs would be concluded. Mrs Lau further commented that since Hong Kong was often a hub for regional and global business, many multinational entities dealt through subsidiaries that were located in jurisdictions with which Hong Kong did not have DTAs. She cited the example of a Hong Kong taxpayer who purchased products from the Mainland and sold them to the US. The former would qualify for a bilateral APA, but not the latter because there was no tax treaty between Hong Kong and the US. However, these transactions were all integrated, and it was unreasonable simply to have an APA for one leg but not the other.

CIR noted that, with the resources constraint in the IRD, unilateral APA would have to be limited at least at the initial stage of implementation. As regards the issue cited by Mrs Lau, CIR agreed that if the situation permitted, so long as the transaction between Hong Kong and the other jurisdiction (e.g. Hong Kong and the US) formed part and parcel of the whole transaction, a unilateral APA would be considered. However, it must be noted that such APA would not be binding on that other jurisdiction.

Agenda Item B4 – Date of Next Annual Meeting

The final 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 2008/09 to 2010/11

	Y/A 2008/09	Y/A 2009/10	Y/A 2010/11	Comparison 2009/10 and 2010/11
1. Bulk issue (on 1 April)	158,000	164,000	168,000	2%
2. Cases with a failure to file by due date:-				
'N' Code	1,600	1,800	1,900	6%
'D' Code	4,900	4,100	4,600	12%
'M' Code	8,300	8,300	8,900	7%
	14,800	14,200	15,400	8%
3. Compound offers issued	5,400	5,100	5,600	10%
4. Estimated assessments issued	5,800	5,200	6,000	15%

Table 2
2010/11 Detailed Profits Tax Returns Statistics

	'N'	'D'	'M'	Total
Total returns issued	18,000	52,000	98,000	168,000
Failure to file on time	1,900	4,600	8,900	15,400
Compound offers issued	800	1,900	2,900	5,600
Estimated assessments issued	700	1,700	3,600	6,000

Table 3
Represented Profits Tax Returns - Lodgement Patterns

Code	Lodgement Standard	Actual Performance (cumulative) 2010/11 PTRs	2009/10 PTRs
D - 15 August	100%	79% (1)	81%
M - 31 August	25%	11%	11%
M - 30 September	55%	16%	17%
M - 31 October	80%	33%	35%
M - 15 November	100%	79% (2)	80%

(1) 36% lodged within a few days around 15 August 2011 (35% lodged within a few days around 16 August 2010 for 2009/10 PTRs)

(2) 32% lodged within a few days around 15 November 2011 (32% lodged within a few days around 15 November 2010 for 2009/10 PTRs)

Table 4
Tax Representatives with Lodgement Rate of less than 79% of 'M' code Returns as at 15 November 2011

1,532 T/Rs have 'M' Code clients. Of these, 685 firms were below the average performance rate of 79%.
An analysis of the firms, based on size, is:-

		Current Year Performance				Last Year Performance			
	No. of clients per firm	Total No. of firms	No. of firms below the average of 79%	No. of non-compliance cases	% of total non-compliance cases	Total No. of firms	No. of firms below the average of 80%	No. of non-compliance cases	% of total non-compliance cases
Small size firms	100 or less	1,401	633	5,445	69%	1,418	652	5,212	70%
Medium size firms	101 - 300	120	49	2,153	27%	122	45	1,915	26%
Large size firms	over 300	11	3	319	4%	12	4	327	4%
		1,532	685	7,917	100%	1,552	701	7,454	100%

Appendix B

Analysis of Completed FA Corporation Cases for the years ended 31 December 2009, 2010 and 2011

	Number			Discrepancy Amount by Nature			Tax Undercharged by Nature		
Auditor's Report = Unqualified	**2009**	**2010**	**2011**	**2009**	**2010**	**2011**	**2009**	**2010**	**2011**
Sales omitted	37	35	42	26,238,198	39,231,439	53,386,046	4,491,152	5,314,753	5,984,227
Purchases overstated	12	9	13	12,596,287	16,137,588	30,184,316	2,272,691	2,681,964	4,878,078
Gross profit understated	31	35	29	108,782,698	108,899,917	84,801,142	17,872,130	19,245,306	10,808,430
Expenses over-claimed	51	55	78	66,310,819	33,263,505	85,763,465	10,744,485	5,297,220	10,782,119
Technical adjustments	52	70	80	23,543,334	103,312,165	61,121,856	3,792,798	16,062,359	8,908,455
Offshore income / profits disallowed	17	15	13	196,242,025	687,681,260	121,529,355	33,284,970	113,737,761	20,244,418
Other	54	92	78	98,990,681	115,850,683	148,985,403	15,973,551	16,108,434	21,910,249
TOTAL	254*	311*	333*	$532,704,042	$1,104,376,557	$585,771,583	$88,431,777	$178,447,797	$83,515,976
TOTAL NUMBER OF CASES	189*	235*	240*						
AVERAGE AMOUNT PER CASE				$2,818,540	$4,699,475	$2,440,715	$467,893	$759,352	$347,983

FOR AUDIT YEAR ONLY

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

				Total Discrepancy for All Years			Total Tax Undercharged for All Years		
				2009	**2010**	**2011**	**2009**	**2010**	**2011**
Other statistics for the above cases:	**TOTAL AMOUNT**			**$2,551,595,640**	**$6,040,296,560**	**$3,128,304,734**	**$398,570,394**	**$980,325,950**	**$502,706,126**
	AVERAGE AMOUNT PER CASE			**$13,500,506**	**$25,703,390**	**$13,034,603**	**$2,108,838**	**$4,171,600**	**$2,094,609**

	Number			Discrepancy Amount by Nature			Tax Undercharged by Nature		
Auditor's Report = Qualified	**2009**	**2010**	**2011**	**2009**	**2010**	**2011**	**2009**	**2010**	**2011**
Sales omitted	10	5	9	14,273,262	1,954,675	5,524,645	2,479,177	365,202	684,626
Purchases overstated	0	1	1	0	1,497,436	619,277	0	0	109,805
Gross profit understated	8	9	12	5,290,375	18,236,737	25,211,810	653,385	2,915,120	3,966,081
Expenses over-claimed	8	11	7	3,214,532	15,310,258	4,820,821	582,712	2,422,734	221,930
Technical adjustments	18	6	14	9,633,270	4,497,427	9,825,491	1,591,641	465,541	1,666,856
Offshore income / profits disallowed	0	2	5	0	7,314,612	47,638,540	0	705,035	8,307,655
Other	13	10	14	2,439,655	17,646,090	15,559,517	318,985	2,820,659	2,567,318
TOTAL	57*	44*	62*	$34,851,094	$66,457,235	$109,200,101	$5,625,900	$9,694,291	$17,524,271
TOTAL NUMBER OF CASES	40*	37*	47*						
AVERAGE AMOUNT PER CASE				$871,277	$1,796,141	$2,323,406	$140,648	$262,008	$372,857

FOR AUDIT YEAR ONLY

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

				Total Discrepancy for All Years			Total Tax Undercharged for All Years		
				2009	**2010**	**2011**	**2009**	**2010**	**2011**
Other statistics for the above cases:	**TOTAL AMOUNT**			**$157,641,033**	**$421,381,642**	**$604,348,303**	**$25,628,675**	**$64,295,339**	**$98,746,514**
	AVERAGE AMOUNT PER CASE			**$3,941,026**	**$11,388,693**	**$12,858,475**	**$640,717**	**$1,737,712**	**$2,100,990**

				Total Discrepancy for All Years			Total Tax Undercharged for All Years		
TOTAL NUMBER OF CASES	229	272	287						
				2009	**2010**	**2011**	**2009**	**2010**	**2011**
Other statistics for the above cases:	**TOTAL AMOUNT**			**$2,709,236,673**	**$6,461,678,202**	**$3,732,653,037**	**$424,199,069**	**$1,044,621,289**	**$601,452,640**
	AVERAGE AMOUNT PER CASE			**$11,830,728**	**$23,756,170**	**$13,005,760**	**$1,852,398**	**$3,840,519**	**$2,095,654**