

DECEMBER 2018 AND JUNE 2019
SUPPLEMENT

Qualification Programme

Module D

Taxation



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

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Introduction

This Supplement is to be used in conjunction with the sixth edition of the Learning Pack, and it will bring you fully up to date for developments that have occurred in the period since publication of the Learning Pack up to 31 May 2018, the cut-off date for examinable contents for the December 2018 and June 2019 examinations.

The Supplement comprises a technical update on developments that will be examinable in December 2018 and June 2019 examination sessions that are not currently covered in the Learning Pack. The topics covered are listed on the contents page, and again are covered in chapter order.

In each case the text in the Supplement explains how the Learning Pack is affected by the change, for example whether the new material should be read in addition to the current material in the Learning Pack, or whether the new material should be regarded as a replacement.

Good luck with your studies!

Part A: Identified Errata**Chapter 3 Hong Kong profits tax**

**Section 9.4.8 Under section 9.4.8 Assets brought into business after non-business use:
Page 249 ss.37(2A) & 39B(6), replace the first paragraph with the following
paragraph:**

When an asset previously acquired for private use is subsequently brought into business use, no initial allowance is granted as no capital expenditure is incurred. Annual allowance is to be computed based on the deemed cost of the asset (i.e. actual cost of the asset less notional amount of annual allowances for the period of non-business use) transferred into the respective pool.

Part B: Technical Updates

Note: All the amounts quoted in \$ in this Supplement are HK\$.

Tax tables

Page xx Remove '& onwards' from the caption of 'Year of assessment 2017/18 & onwards' on page xx.

Then, add the following new table on page xx:

Year of assessment 2018/19

	Net Chargeable Income (\$)	Rate	Tax
On the First	50,000	2%	1,000
On the Next	50,000	6%	3,000
On the Next	50,000	10%	5,000
On the Next	<u>50,000</u>	14%	<u>7,000</u>
	200,000		16,000
Remainder		17%	

Then, add the following note under the above tax rate table for 2018/19:

For 2017/18, 75% of the final tax payable under profits tax, salaries tax and tax under personal assessment would be waived, subject to a ceiling of \$30,000 per case.

Personal allowances

	2018/19
Allowances	
Basic allowance	132,000
Married person's allowance	264,000
Child allowance – 1st to 9th child (each)	120,000
New born child – additional allowance in the year of birth (each)	120,000
Single parent allowance	132,000
Dependent parent/grandparent allowance (each) (Age 55-59/≥60)	25,000/50,000
Additional dependent parent/grandparent allowance (each) (Age 55-59/≥60)	25,000/50,000
Dependent brother/sister allowance (each)	37,500
Disabled dependant allowance (each)	75,000
Personal disability allowance (Note: new allowance starting from 2018/19)	75,000
Deductions	
Self-education expenses (max.)	100,000
Elderly residential care expenses (max.)	100,000
Home loan interest (max.)#	100,000
MPF (max.)	18,000
Approved charitable donations (max.)@	35%

Chapter 1 The tax system in Hong Kong
Topic list Add the following sections to the topic list:
Page 3 7.12 Two-tiered profits tax rates regime

7.13 Transfer pricing documentation and Country-by-Country Reporting

Section 1.3 Replace the third paragraph of section 1.3 on page 5 by:
Pages 5 and 6

As of 1 June 2018, Hong Kong has concluded comprehensive double taxation agreements with 40 jurisdictions including Belgium, Thailand, the mainland of China, Luxembourg, Vietnam, Brunei, the Netherlands, Indonesia, Hungary, Kuwait, Austria, the United Kingdom, Ireland, Liechtenstein, France, Japan, New Zealand, Switzerland, Portugal, Spain, the Czech Republic, Malta, Jersey, Malaysia, Mexico, Canada, Italy, Guernsey, Qatar, Korea, South Africa, United Arab Emirates ('UAE'), Romania, Russia, Latvia, Belarus, Pakistan, Saudi Arabia, India and Finland.

Modify the table in section 1.3 on page 6 as follows:

Country	CDTA/ Protocol	Gazetted	Came into force	Take effect
Latvia	CDTA	30 June 2017	24 Nov 2017	Y/A 2018/19
Belarus	CDTA	30 June 2017	30 Nov 2017	Y/A 2018/19
Pakistan	CDTA	30 June 2017	24 Nov 2017	Y/A 2018/19
Saudi Arabia	CDTA	In progress	Pending	Pending
India	CDTA	In progress	Pending	Pending
Finland	CDTA	In progress	Pending	Pending

Section 4.5 Modify/add the following under section 4.5 on pages 15 and 17 as below:
Pages 15 and 17

A list of DIPNs issued/revised by the IRD (as at 1 June 2018) is as follows:

Add the following to section 4.5 (Table of DIPNs) on page 17:

No.	Subjects	Date of issue
54	Taxation of Aircraft Leasing Activities	Oct 2017

Section 5.2 Modify the profits tax rates of section 5.2 on page 20 as follows:

Page 20

	From 2008/09 to 2017/18	Starting from 2018/19	
Corporations	16.5%	First \$2 million assessable profits	8.25%
		Remaining	16.5%
Partnership	Corporate partners' share of profit – 16.5%;	Corporate partners' share of profit	
		First \$2 million assessable profits	8.25%
		Remaining	16.5%
		Unincorporated partners' share of profit – 15%	Unincorporated partners' share of profit
Unincorporated business	Standard rate (15%)	First \$2 million assessable profits	7.5%
		Remaining	Standard rate (15%)
		First \$2 million assessable profits	7.5%
		Remaining	Standard rate (15%)

Modify the progressive tax rates of section 5.2 on page 20 as follows:**2017/18 (Note)**

First \$45,000	2.0%
Next \$45,000	7.0%
Next \$45,000	12.0%
Balance	17.0%

2018/19 (Note)

First \$50,000	2.0%
Next \$50,000	6.0%
Next \$50,000	10.0%
Next \$50,000	14.0%
Balance	17.0%

Section 5.2 Add the following at the end of section 5.2 on page 21:**Page 21**

There is a partial tax reduction for 2017/18 as a relief measure. All taxpayers liable to profits tax, salaries tax or tax under personal assessment have a reduction of 75% of the 2017/18 final tax, subject to a ceiling of \$30,000 per case.

Section 7.3 Replace section 7.3 on pages 24 and 25 with the following:**Pages 24 and 25****7.3 Tax measures proposed by the 2018/19 Budget**

Under the 2018/19 Budget, the following tax measures were proposed:

- Reduce profits tax, salaries tax and tax under personal assessment for 2017/18 by 75%, subject to a ceiling of \$30,000 per case.
- Increase child allowance to \$120,000 from 2018/19 onwards.
- Increase basic dependent parent/grandparent allowance (aged 60 or above) from \$46,000 to \$50,000 each from 2018/19 onwards.
- Increase additional dependent parent/grandparent allowance (aged 60 or above) from \$46,000 to \$50,000 each from 2018/19 onwards.
- Increase basic dependent parent/grandparent allowance (aged between 55 to 59) from \$23,000 to \$25,000 each from 2018/19 onwards.
- Increase additional dependent parent/grandparent allowance (aged between 55 to 59) from \$23,000 to \$25,000 each from 2018/19 onwards.
- Introduce a new allowance, named personal disability allowance, of \$75,000 from 2018/19 onwards.
- Increase the deduction ceiling of elderly residential care expenses from \$92,000 to \$100,000 from 2018/19 onwards.
- Introduce a tax deduction of qualified premium for eligible health insurance products under the Voluntary Health Insurance Scheme. The annual deduction threshold is \$8,000 per insured person.
- Changes of tax bands and marginal tax rates for progressive tax rates. (Refer to abovementioned changes).

- Extend the tax exemption/reduction on qualifying debt instruments with maturity of any duration and debt securities listed on the Hong Kong Stock Exchange.
- Enhance tax concessions for capital expenditure incurred in connection with the purchase of eligible efficient building installations and renewable energy devices by allowing tax deduction to be claimed in full in one year instead of the current time frame of five years.
- A rate waiver for all four quarters, subject to a cap of \$2,500 per quarter, for each rateable property.

Section 7.6 **Modify the second paragraph of section 7.6 on page 27 as follows:**

Pages 27 and 28 As of 1 June 2018, Hong Kong has concluded TIEAs with seven jurisdictions including the United States, Denmark, the Faroes, Greenland, Iceland, Norway and Sweden.

Then, add the following before the last sentence of section 7.6 on page 28:

The Inland Revenue (Amendment) (No. 2) Ordinance 2017 was gazetted on 16 June 2017 and came into effect from 1 July 2017.

From 1 July 2017, the list of 'reportable jurisdictions' under the Inland Revenue Ordinance will be expanded to cover 75 jurisdictions, comprising those confirmed AEOI partners and prospective AEOI partners.

The Inland Revenue (Amendment) Ordinance 2018 was gazetted on 2 February 2018. The technical amendments on AEOI (i.e. clauses 5 to 11) under the (Amendment) Ordinance 2018 will come into operation on 1 January 2019 while other provisions take effect on 2 February 2018.

The (Amendment) Ordinance 2018 provides the legal framework for Hong Kong to implement multilateral tax arrangements and thereby allows more effective implementation of the arrangements relating to AEOI as well as automatic exchange of Country-by-Country Reports and spontaneous exchange of information on tax rulings under the BEPS package.

Section 7.11 **Add the following before the last sentence of section 7.11 on page 30:**

Page 30 In July 2017, the Inland Revenue (Amendment) (No. 3) Ordinance 2017 was enacted to give profits tax concessions to corporations carrying on certain businesses in connection with aircraft.

DIPN 54 was issued in October 2017 setting out the IRD's interpretation and practice in relation to the relevant provisions under the Inland Revenue (Amendment) (No. 3) Ordinance 2017.

New section 7.12 **Add the following new section 7.12 after section 7.11 on page 30:**

Page 30 **7.12 Two-tiered profits tax rates regime**

The Inland Revenue (Amendment) (No. 3) Ordinance 2018 was gazetted on 29 March 2018. The Ordinance seeks to implement the two-tiered profits tax rates regime starting from the year of assessment 2018/19.

For corporations, the profits tax rate for the first \$2 million of assessable profits will be lowered to 8.25%. The portion of assessable profits exceeding \$2 million will continue to be subject to a rate of 16.5%. Only one corporation within a group of connected entities can enjoy the two-tiered profits tax regime.

For unincorporated businesses which are mostly partnerships and sole proprietorships, the two-tiered tax rates will correspondingly be set at 7.5% and 15%.

**New section
7.13**

Add the following new section 7.13 after section 7.11 and new section 7.12 on page 30:

Page 30

7.13 Transfer pricing documentation and Country-by-Country Reporting

The Inland Revenue (Amendment) (No. 6) Bill 2017 was gazetted on 29 December 2017 setting out the requirements of Master File, Local File and the implementation framework for Country-by-Country (CbC) Reporting in Hong Kong.

CbC Reporting is a minimum standard formulated by the OECD under Action 13 of the BEPS Package.

CbC Reports are to be exchanged automatically between tax authorities under relevant exchange arrangements.

Refer to **Chapter 12** for details.

Add the following new cases to Appendix – Summary of cases relating to administrative procedures under the IRO (page 85):

Taxpayer [Ref.]	Subject matter	Extract of facts and determination
CIR v Slipform Engineering International (HK) Limited [DCTC 1325/2016]	Recovery of tax payments	<p>The taxpayer is carrying on the business of investment holding and provision of project management services for construction contracts.</p> <p>During the years of assessment 2008/2009 and 2009/2010, substantially all of the taxpayer's relevant income was derived from project management fee income paid or receivable under various management and construction contracts entered with its related party which is an Australian company listed on the Australian Stock Exchange.</p> <p>The taxpayer had engaged affiliated companies in discharging consultation, management and administrative services for those projects.</p> <p>The IRD relied on s.61 and s.61A of the IRO to disregard the related party transactions and alleged that the transactions entered between the taxpayer and those affiliated companies were artificial or fictitious, and/or effected for the sole or dominant purpose for obtaining a tax benefit.</p> <p>The taxpayer has objected to such allegations and has filed several objections.</p> <p>The court rejected the taxpayer's argument. Tax should always be paid first under s.71 notwithstanding any notice of objection or appeal, and any allegation which relates to the assessment being excessive or incorrect should not be entertained in a recovery proceeding under s.75(4).</p>

Taxpayer [Ref.]	Subject matter	Extract of facts and determination
CIR v Energy World (HK) Limited [DCTC 139/2017]	Recovery of tax payments	<p>The IRD sued the taxpayer for a sum being profits tax due and unpaid under s.75 of the IRO.</p> <p>The taxpayer filed and served its defence on 30 March 2017 stating various grounds and alleging the assessment unreasonable, wrong and incorrect in law and facts.</p> <p>The IRD's striking out was launched relying on s.75(4) of the IRO.</p> <p>The court rejected the taxpayer's defence. Tax shall be paid notwithstanding any notice of objection or appeal, unless the Commissioner orders that payment of tax or any part thereof be held over pending the result of such objection or appeal.</p>

Chapter 3 Hong Kong profits tax

Topic list Add the following sections to the Topic list:

Page 103 1.3 Two-tiered profits tax rates regime
5.9 Taxation of aircraft leasing activities

New section Add a new section 1.3 after section 1.2:

1.3

Page 108

1.3 Two-tiered profits tax rates regime: ss.14(2)–(5) and Schedules 8 & 8A

The Inland Revenue (Amendment) (No. 3) Ordinance 2018 was gazetted on 29 March 2018. The new law introduces a two-tiered profits tax rates regime, commencing from the year of assessment 2018/19, as follows:

Assessable profits	Tax rates	
	Corporation*	Unincorporated business
First HK\$2 million	8.25%	7.5%
Over HK\$2 million	16.5%	15%

* When a corporation is a partner of a partnership, the concessionary tax rate of 8.25% will only apply to the first HK\$2 million pro-rated by its share in the partnership.

1.3.1 Connected entities to nominate a single entity for the two-tiered rates

To ensure that the tax benefits will target small and medium enterprises and start-up enterprises, and to prevent income splitting among group enterprises, a group of 'connected entities' can only elect one entity within the group to enjoy the two-tiered rates for a given year of assessment (s.14AAC). The election, once made, is irrevocable.

The connected relationship is determined by their status at the end of the basis period. An entity is a connected entity of another entity if (s.14AAB(1)):

- (i) one of them has control over the other;
- (ii) both of them are under the control of the same entity; or
- (iii) in the case of the first entity being a natural person carrying on a sole proprietorship business, the other entity is the same person carrying on another sole proprietorship business.

'Control' generally refers to having directly or indirectly more than 50% of the issued share capital, voting rights, or entitlement to capital or profits of another entity (s.14AAB(4)).

1.3.2 No double benefits for taxpayers that are eligible for the preferential half-rate tax regimes: s.14(5)

To avoid double benefits, if a corporation has elected to be subject to the preferential half-rate tax regimes for qualifying profits derived from their businesses of reinsurance, captive insurance, corporate treasury centres, aircraft leasing or aircraft leasing management under ss.14B(2)(a), 14D(5)(b), 14H(4)(b) or 14J(5)(b) (see the discussion in **section 5.2** on 'Concessionary trading receipts chargeable to tax at half of the profits tax rate'), it will be excluded from the two-tiered profits tax rates regime. The remaining non-qualifying profits will be subject to the full tax rate.

1.3.3 Income from qualifying debt instruments not counted towards the first HK\$2 million threshold

Profits derived from qualifying debt instruments which are already taxed at the half rate under s.14A (see the discussion in **section 5.2** on 'Concessionary trading receipts chargeable to tax at half of the profits tax rate') will not be counted towards the first HK\$2 million threshold under the two-tiered profits tax rates regime. Unlike the above preferential half-rate tax regimes for reinsurance, captive insurance, corporate treasury centres, aircraft leasing and aircraft leasing management, the entity itself is not excluded from the two-tiered profits tax rates regime.

Section 5.1 Page 136

Under section 5.1 Sums specifically chargeable to profits tax, add the following section after ss.15(1)(m) and 15A in the table:

Section	Sums specifically chargeable to profits tax
15(1)(n)	<p>Sums received by or accrued to a corporation by way of gains or profits (other than those arising from the sale of capital assets) arising through or from the carrying on in Hong Kong by the corporation of:</p> <ul style="list-style-type: none"> (i) its business of granting a right to use an aircraft to another person (aircraft business), even if the aircraft is used outside Hong Kong; or (ii) its business of managing a corporation carrying on an aircraft business or of managing an aircraft business, even if the aircraft concerned is used outside Hong Kong. <p>The taxation of aircraft leasing activities is discussed in section 5.9.</p>

Example 15 Pages 137 and 138

In part (a) of the solution, revise the tax rate of 15% to 7.5%, and the profits tax payable of \$4,500 to \$2,250 (under the two-tiered profits tax regime).

In part (b) of the solution, revise the tax rate of 15% to 7.5%, and the profits tax payable of \$9,000 to \$4,500 (under the two-tiered profits tax regime).

In part (c) of the solution, revise the tax rate of 15% to 7.5%, and the profits tax payable of \$30,000 to \$15,000 (under the two-tiered profits tax regime).

Section 5.2
Page 139

Under section 5.2 Concessionary trading receipts chargeable to tax at half of the profits tax rate, replace the first paragraph with the following paragraph, and add the following sections after s.14D in the table:

Income derived from qualifying debt instruments (short or medium term), assessable profits of an insurance company derived from qualifying business of reinsurance or insurance of offshore risks, qualifying profits of a qualifying corporate treasury centre, qualifying aircraft lessor and qualifying aircraft leasing manager, are only taxed at half of the profits tax rate.

Taxpayer	Concessionary trading receipts chargeable to tax at half of the profits tax rate
14H	<p>Qualifying profits derived from qualifying aircraft leasing activity carried on by a qualifying aircraft lessor, effective from 1 April 2017 (discussed in section 5.9 on 'Taxation of aircraft leasing activities').</p> <p>An election for the tax concession, once made, is irrevocable.</p>
14J	<p>Qualifying profits derived from qualifying aircraft leasing management activity carried on by a qualifying aircraft leasing manager, effective from 1 April 2017 (discussed in section 5.9 on 'Taxation of aircraft leasing activities').</p> <p>An election for the tax concession, once made, is irrevocable.</p>

New section
5.9
Page 171

Add a new section 5.9 after section 5.8.3:

5.9 Taxation of aircraft leasing activities

To strengthen the development of offshore aircraft leasing activities in Hong Kong, thereby enhancing the status of Hong Kong as an international financial centre and the soft power of Hong Kong in being an international aviation hub, the Inland Revenue (Amendment) (No. 3) Ordinance 2017 was enacted on 7 July 2017 to:

- (a) Provide a half-rate concession for **qualifying aircraft lessors** ('QAL') and **qualifying aircraft leasing managers** ('QALM');
- (b) Provide a 20% tax base concession for QAL;
- (c) Introduce a new deeming provision for gains or profits arising through or from aircraft leasing business or aircraft leasing managing business carried on in Hong Kong; and
- (d) Limit the amount of tax deduction that can be claimed by a payer who is connected with a QAL or a QALM chargeable to tax at the concessionary tax rate.

The IRD issued DIPN 54 in October 2017 to provide guidance on the application of the profits tax provisions in relation to aircraft leasing activities.

5.9.1 Concessionary tax regime

Under the concessionary tax regime, effective from 1 April 2017:

- (a) Qualifying profits of QAL and QALM will be taxed at the concessionary tax rate of 8.25% (i.e. 50% of the current profits tax rate of 16.5%) (ss.14H(1) and 14J(1)).

Qualifying profits include incidental income such as interest income, exchange gains or hedging gains, to the extent that the relevant transactions are ancillary to the qualifying activities (DIPN 54, para. 11 and 38).

- (b) In lieu of tax depreciation allowances, the deemed taxable amount in respect of income derived from the leasing of aircraft to an aircraft operator by a QAL will be equal to 20% of the net rentals, i.e. gross rentals less deductible expenses, but excluding tax depreciation allowances (s.14I).

The half-rate concession applies to a QAL and a QALM for a year of assessment only if:

- (a) The central management and control ('CMC') of the corporation must be exercised in Hong Kong (**the CMC requirement**) (ss.14H(4)(a)(i) and 14J(5)(a)(i));
- (b) The profit generating activities must be carried out in Hong Kong by the corporation; or arranged by the corporation to be carried out in Hong Kong (**the substantial activity requirement**) (ss.14H(4)(a)(ii) and 14J(5)(a)(ii));
- (c) Those activities are not carried out by a permanent establishment outside Hong Kong (**the attribution to Hong Kong requirement**) (ss.14H(4)(a)(iii) and 14J(5)(a)(iii));
- (d) The corporation must be a corporation that is not an aircraft operator, and only carries out qualifying aircraft leasing activities or qualifying aircraft leasing management activities and no other activities in Hong Kong (**the standalone corporation requirement**) (ss.14H(2), 14J(2)(a), 2(b)(i) & (3); and
- (e) The corporation has elected in writing that the half-rate concession applies to it (ss.14H(4)(b) and 14J(5)(b)).

An aircraft lessor or an aircraft leasing manager will have its CMC in Hong Kong if its executive officers and senior management predominantly exercise day-to-day responsibility for the strategic, financial and operational policy decision making of the entity in Hong Kong and predominantly conduct the day-to-day activities necessary for making such decisions in Hong Kong (DIPN 54, para. 61).

To satisfy 'the substantial activity requirement', the core income generating activities which produce the qualifying profits of a QAL or a QALM, need to be carried out in Hong Kong. Such activities include raising funds, agreeing funding terms, identifying and acquiring aircraft to be leased, soliciting lessees, setting the terms and duration of leases, monitoring and revising lease agreements, managing any risks and maintaining documentation (DIPN 54, para. 67).

In order to assist the IRD to consider whether 'the substantial activity requirement' is satisfied, it is important for taxpayers to submit a realistic business plan for carrying out their aircraft leasing activities in Hong Kong in the year in which the aircraft leasing activity commences. For lessors that are established as an SPV to hold an aircraft, it may be necessary to consider whether such an SPV has sufficient connection or nexus with the active conduct of aircraft leasing activity in Hong Kong, including the engagement of an aircraft leasing manager carrying on business in Hong Kong (DIPN 54, para. 70).

Example 1 (Adapted from DIPN 54, Example 8)

Overseas Trading Company-F set up SPV-HK, a QAL in Hong Kong, for holding a private jet which was leased to the company at a non-arm's length rent. SPV-HK did not have employees in Hong Kong, and was not managed by a QALM in Hong Kong. It had two nominee directors and used the business address of a Hong Kong secretarial firm as its registered address.

It appears that the above leasing arrangement might be used for shifting overseas income to the half rate regime in Hong Kong for tax avoidance purpose. SPV-HK did not have business substance in Hong Kong except merely owning the private jet. In the circumstances, the Commissioner would not accept that the CMC and substantial activity requirements were satisfied.

In determining whether a corporation has carried out any activity other than a qualifying aircraft leasing activity or qualifying aircraft leasing management activity, only activities that generate income to the corporation are to be taken into account (ss.14H(3) and 14J(4)). Therefore, expense transactions such as taking a lease in respect of the business premises for carrying out qualifying aircraft leasing activities or sponsoring an international industry conference for marketing purpose would be excluded (DIPN 54, para. 15).

Key terms in ss.14G(1) and Schedule 17F

'Aircraft' includes an aeroplane, airframe, aircraft engine and helicopter; but does not include an aircraft solely for military use, airship, spacecraft or satellite.

'Aircraft leasing activity' is defined in s.1 of Schedule 17F to mean leasing an aircraft by the corporation to an aircraft operator.

'Aircraft operator' means a person carrying on an aircraft operation business.

'Aircraft operation business' means a business of operating aircraft as an owner or a charterer for providing services for the carriage by air of passengers, cargo or mail; but does not include dealing in aircraft or agency business in connection with air transport.

'Aircraft leasing management activity' is defined in s.1 of Schedule 17F to mean any of the following activities:

- (a) Managing another corporation that is a relevant QAL;
- (b) Establishment or administration of a special purpose entity for the purpose of owning an aircraft by that entity;
- (c) Providing finance in obtaining the ownership of an aircraft by a special purpose entity wholly or partly owned by the corporation or its associated corporation;
- (d) Providing a guarantee in respect of a financial or performance obligation as regards the aircraft leasing business of a special purpose entity wholly or partly owned by the corporation or its associated corporation, or granting security in respect of that business;
- (e) Managing leases;
- (f) Arranging for the procurement or leasing of aircraft;
- (g) Arranging for the operation, maintenance, repair, insurance, storage, scrapping or modification of aircraft;
- (h) Arranging for the evaluation, appraisal, provision or inspection of aircraft, airline facilities or maintenance facilities for aircraft;
- (i) Arranging for the assessment of the aviation and aircraft market conditions;
- (j) Marketing of leases that are operating leases;
- (k) Providing finance in obtaining the ownership of an aircraft by an airline enterprise from another corporation that is a relevant QAL;

- (l) Providing a residual value guarantee or contingent purchase arrangement;
- (m) Providing services in relation to an aircraft leasing activity for or to another corporation that is a relevant QAL.

'Lease', when used as a noun, means a dry lease; but does not include a dry lease that is a funding lease, hire-purchase agreement or conditional sale agreement; and when used as a verb, is to be construed accordingly.

'Dry lease' means an arrangement under which:

- (a) An aircraft is bona fide demised, let or hired out, or a right to use an aircraft is otherwise granted, by a person (lessor) to another person for a term exceeding one year;
- (b) The lessor is not responsible for ensuring the airworthiness of the aircraft; and
- (c) No member of the crew of the aircraft is employed by the lessor.

5.9.2 Tax treatment for qualifying aircraft lessor

The tax concession

The tax rate on the qualifying profits of a QAL will be only 8.25%, and this reduced tax rate will be applied to only 20% of the usual tax base of the QAL (i.e. gross lease payments less deductible expenses, excluding tax depreciation allowances). As a result, the effective tax rate on the net lease payments derived from the offshore leasing of aircraft by a QAL will be 1.65% only (i.e., $20\% \times 8.25\%$) (s.14I(1) and (2)). If the half-rate concession applies to a corporation, it will not be entitled to any tax depreciation allowances (s.14H(7)).

Qualifying profits generally refer to profits derived from the leasing of an aircraft owned by the QAL in its ordinary course of business in Hong Kong to a non-Hong Kong aircraft operator (i.e., profits derived from such qualifying aircraft leasing activities). **'Non-Hong Kong aircraft operator'** means an aircraft operator who is not chargeable to profits tax in Hong Kong.

An aircraft leasing activity carried out by a corporation in respect of an aircraft is a **'qualifying aircraft leasing activity'** if (s.14G(6)):

- (a) The activity is carried out in the ordinary course of the corporation's business carried on in Hong Kong; and
- (b) The aircraft is owned by the corporation when the activity is carried out.

The word 'own' in s.14G(1) refers to economic ownership, and includes holding an aircraft:

- (a) As a lessee under a funding lease;
- (b) As a bailee under a hire-purchase agreement; and
- (c) As a buyer under a conditional sale agreement.

If the aircraft lessor acquires an aircraft through these financing arrangements, the ownership of the aircraft would be regarded as having been acquired by the aircraft lessor even though legal title to the aircraft has not yet been transferred to the aircraft lessor (DIPN 54, para. 33). However, if the property in the aircraft would unlikely pass to the aircraft lessor, the aircraft would not be regarded as having been acquired by the aircraft lessor. Thus, leasing of such an aircraft to an aircraft operator would not qualify for the tax concessions (DIPN 54, para. 35).

If an aircraft lessor grants a right to use an aircraft to an aircraft operator under a funding lease, hire-purchase arrangement or conditional sale agreement, the ownership of the aircraft in effect is transferred to the aircraft operator and thus the aircraft lessor will not qualify for the tax concessions (DIPN 54, para. 24).

Example 2 (Adapted from DIPN 54, Example 10)

Qualifying Aircraft Lessor-HK granted the right to use an aircraft to Aircraft Operator-HK under a hire-purchase agreement with a purchase option. Aircraft Operator-HK then leased the aircraft to Aircraft Operator-F, a non-Hong Kong aircraft operator.

Aircraft Operator-HK would be regarded as having obtained ownership of the aircraft. However, it would not be granted depreciation allowances under s.39E despite that s.23C would apply to assess the charter hire received from Aircraft Operator-F.

As for Qualifying Aircraft Lessor-HK, the hire-purchase agreement would fall outside the definition of 'lease' under s.14G(1) and hence Qualifying Aircraft Lessor-HK is not entitled to the profits tax concessions under the aircraft leasing regime. The interest element of the lease payments received would be assessed at full rate.

If Qualifying Aircraft Lessor-HK granted the right to use the aircraft to Aircraft Operator-HK by way of an operating lease, Qualifying Aircraft Lessor-HK could elect into the aircraft leasing regime to enjoy the profits tax concessions.

In order to qualify for the concession, the aircraft must be owned by the corporation claiming the concession. However, there may be a commercial need to interpose an intermediate lessor set up in the lessee jurisdiction or a third jurisdiction (e.g. to isolate financial risks or to allow for easier transfer of the aircraft). Under the arrangement, the intermediate lessor, which is not itself an aircraft operator, leases an aircraft from the lessor and then on-leases the same to an aircraft operator. Nonetheless, the IRD would carefully examine the facts of each case in order to ascertain if a leasing arrangement involving the interposition of an intermediate lessor is one for which the profits tax concession was intended. In the absence of any tax avoidance arrangement, the IRD may consider that the 'ownership' requirement is satisfied and allow the lessor in such situation to enjoy the proposed tax concessions (DIPN 54, paras. 22 and 37).

Therefore, leases transferring title or giving an option to acquire the aircraft will not qualify for the concession. However, where a separate agreement provides a purchase option which merely allows the lessee to acquire the aircraft at its fair market value at the end of the lease, this will be treated as a separate transaction not connected with the lease, thereby allowing the lessor to qualify for the tax concession (DIPN 54, para. 27).

20% tax base concession

A QAL will be denied the 20% tax base concession under the following circumstances (s.14I(3)):

- (a) The lessor has not incurred capital expenditure on the provision of the aircraft concerned;
- (b) The QAL or its connected person has been granted tax depreciation allowances in Hong Kong in respect of the aircraft concerned; or
- (c) Capital allowances are granted to a connected person of the QAL, whether in Hong Kong or in a territory outside Hong Kong, for the year of assessment in question in respect of the capital expenditure on the provision of the aircraft concerned.

If an aircraft is leased to an aircraft operator together with other dealings in pursuance of one bargain, for calculating the net lease payments, the Commissioner is empowered to allocate an amount of gross lease payments for the right to use the aircraft under the lease having regard to all the circumstances of the bargain (s.14I(4)). However, s.14I(4) would apply if the terms of the lease and other dealings are negotiated together such that the gross lease payments would not reflect the market rental of the aircraft.

Example 3 (Adapted from DIPN 54, Example 1)

In a sale and leaseback transaction, an aircraft operator sold an aircraft to a QAL at a deflated price. In return, it could lease back the aircraft from the QAL at a deflated monthly lease payment for a fixed period of time.

Since the sale price of the aircraft and gross lease payments are negotiated together in pursuance of one bargain, the Commissioner could adjust the gross lease payments under s.14I(4).

Aircraft held for three years or more to be treated as capital assets

An aircraft owned by a QAL is to be treated as a capital asset of the QAL if the QAL (s.14H(8)):

- (a) has used the aircraft for carrying out a qualifying aircraft leasing activity for a continuous period of not less than three years immediately before the QAL disposes of the aircraft; and
- (b) the half-rate concessionary treatment applies in respect of the leasing of the aircraft for all relevant years of assessment.

Therefore, a QAL satisfying the above conditions would not be liable to Hong Kong profits tax in respect of gains derived from the disposal of an aircraft.

5.9.3 Tax treatment for qualifying aircraft leasing manager

The tax concession

The tax rate on the qualifying profits of a QALM will be only 8.25%. Qualifying profits generally refer to profits derived by the QALM from performing aircraft leasing management activities for a QAL in the ordinary course of the business of the QALM in Hong Kong (i.e., profits derived from such qualifying aircraft leasing management activities).

An aircraft leasing management activity carried out by a corporation in respect of an aircraft is a **'qualifying aircraft leasing management activity'** if (s.14G(7)):

- (a) The activity is carried out in the ordinary course of the QALM's business carried out in Hong Kong;
- (b) The activity is carried out for a QAL in respect of an aircraft owned by the QAL, and is leased to an aircraft operator, when the activity is carried out.

When, at the request of a relevant QAL, a QALM provides finance to an airline enterprise for acquiring an aircraft from the relevant QAL, the QALM is assisting the QAL to dispose of an aircraft. Such activity is regarded as having been carried out for the relevant QAL and would qualify for the profits tax concession if other criteria are satisfied (DIPN 54, para. 45).

Safe harbour rule under s.14K

If a corporation is not dedicated solely to carrying out one or more of the qualifying aircraft leasing management activities, it may still qualify as a QALM if it satisfies the prescribed safe harbor rules. A corporation satisfies the safe harbor rule for a year of assessment if it falls within the one-year safe harbor or the multiple-year safe harbour (s.14K(1)).

- (a) **One-year safe harbour** – passes both the aircraft leasing management profits ('ALMP') and aircraft leasing management assets ('ALMA') tests for the year of assessment concerned (s.14K(2)).
- (b) **Multiple-year safe harbour** – the average percentages of the ALMP and ALMA for the year of assessment concerned and the preceding one* or two years of assessment passes both tests (s.14K(3)).

(* if the corporation carries on a business in Hong Kong for less than two years, or has less than two 'consecutive' years of track record (s.14K(4)).

Example 4 (Adapted from DIPN 54, Example 7)

Aircraft Leasing Manager-HK claimed the half rate concession for Year 4. It had the following track record:

Year	Business activity in Hong Kong
Year 1	Active business
Year 2	Dormant business
Year 3	Active business
Year 4	Active business

Though Aircraft Leasing Manager-HK had three years of active business operations in Hong Kong, it was dormant in Year 2, leaving it with just one year prior to the subject year. Therefore, Aircraft Leasing Manager-HK would be regarded as having two years of track record. The average ALMP and ALMA percentages would be computed based on the audited financial statements for Years 3 and 4.

The **ALMP test** is satisfied if the ALMP are not lower than **75% of the total profits**, which is calculated based on the accounting profits irrespective of the source of profits. ALMP means any profits derived from qualifying aircraft leasing management activities (s.14G(1)). If there is substantial loss in exceptional circumstances (e.g. the QAL has become insolvent and the debt has become bad), the Commissioner would consider excluding the loss when computing the percentage for the safe harbour rule (DIPN 54, para. 52).

The **ALMA test** is satisfied if the ALMA are not lower than **75% of the total assets**, which is calculated based on the audited accounts irrespective of the location of the assets. The ALMA include fixed assets that are used to carry out the qualifying aircraft leasing management activities, e.g. office equipment. The ALMA are apportioned if they are partly used for carrying out a qualifying aircraft leasing management activity and partly for another purpose (s.14K(7)).

If an aircraft leasing manager also acts as the holding company for a leasing group, the Commissioner is prepared to exclude equity investments in group companies and dividends from the denominators (i.e. total profits or assets) in calculating the ALMP and ALMA percentages.

Formula to learn (s.14K(5) and (6))

$$\text{ALMP percentage} = \frac{\text{ALMP}}{\text{P}}$$

where:

ALMP means the aggregate amount of the aircraft leasing management profits of the corporation in the basis period for the year of assessment; and

P means the aggregate amount of profits accruing to the corporation from all sources, whether in Hong Kong or not, in the basis period for the year of assessment.

$$\text{ALMA percentage} = \frac{\text{ALMA}}{\text{A}}$$

where:

ALMA means the aggregate value of the aircraft leasing management assets of the corporation as at the end of the basis period for the year of assessment; and

A means the aggregate value of all assets, whether in Hong Kong or not, of the corporation as at the end of the basis period for the year of assessment.

Commissioner's determination

If neither of the above conditions are satisfied, the Commissioner may, on application by a taxpayer, exercise his discretion to determine that the corporation is a QALM if he is of the opinion that the conditions specified in s.14J(3) or the safe harbour rule in s.14K would, in the ordinary course of business of the corporation, have been satisfied for the year of assessment (s.14L).

5.9.4 Election for the concessionary tax rate

An election in writing to apply the concessionary tax rate must be made by the QAL (ss.14H(4)(b)) and QALM (ss.14J(5)(b)). Once made, the election is irrevocable (ss.14H(5) and s.14J(6)) for so long as the lessor or manager remains as a QAL or a QALM.

Where a QAL or a QALM has made an election but failed to qualify as a QAL or a QALM for a particular year (cessation year), the lessor or the manager will be denied the profits tax concessions for that year and the subsequent year of assessment (ss.14H(6)(b) and 14J(7)(b)). This is to prevent abuse and protect fiscal revenue as a corporation may opt in when it derives profits from qualifying operations in order for the concessionary half rate to apply; and opt out when it suffers losses in a subsequent year in order to obtain deduction of losses at full rate. A fresh election is required to be made when the QAL and QALM are entitled to the half rate concession again (ss.14H(6)(a) and 14J(7)(a)).

If a QAL or a QALM merely incurs a tax loss from its qualifying operations, it would not be disqualified from being entitled to the half rate concession. S.14H(1) or 14J(1) still applies and the tax loss can only be set off against its other types of profits at half rate for the purpose of s.19CA. Ss.14H(6)(b) and 14J(7)(b) would not be invoked to deny profits tax concessions to the qualifying corporation for the subsequent year of assessment.

5.9.5 Anti-avoidance provisions in s.14M

The chargeable profits from a transaction between a QAL and its associate in connection with a qualifying aircraft leasing activity should be determined by reference to the amount of profits that would have accrued had the same transaction been carried out at arm's length terms between parties who are not associates (ss.14M(1) and (2)). This arm's length principle also applies to a qualifying aircraft leasing management activity between a QALM and its associate (ss.14M(3) and (4)).

Ss.14M(1) to (4) sets out the conditions where the profits in respect of transactions in connection with a qualifying aircraft leasing activity or a qualifying aircraft leasing management activity between a qualifying entity and its associates may be subjected to adjustment.

Under the aircraft leasing regime, a QAL can own an aircraft via a funding lease, a hire-purchase agreement or a conditional sale agreement. A QAL may defease such ownership arrangement to a third party. The third party takes up the primary obligation to make payments to the head lessor, bailor or seller. The effect of a defeased arrangement is that the QAL is no longer obliged to make payments under the ownership arrangement, and the QAL would be treated as if it had ceased to own the aircraft. Hence, no profits tax concessions will be granted to the QAL in respect of the leasing transaction with the aircraft operator as it is no longer a qualifying aircraft leasing activity as defined in s.14G(6) (s.14M(5)).

5.9.6 Anti-arbitrage provision in s.16(1A)

To prevent tax arbitrage through aircraft leasing transactions between connected persons, s.16(1A) is enacted. Where a Hong Kong aircraft operator (i.e. the lessee) is connected with a QAL or a QALM who is only chargeable to tax at the 8.25% concessionary tax rate in respect of a sum paid by the lessee, the amount of tax deduction that can be claimed by the lessee will be reduced by reference to the amount of tax reduction enjoyed by the QAL or QALM under the concessionary tax regime, i.e. the half-rate concession. Therefore, when ascertaining the amount of deduction that could be allowed to the connected person under s.16(1A), the 20% tax base concession would be ignored.

Connected person, in relation to a corporation, means (s.14G(1)):

- (a) an associated corporation of the corporation;
- (b) a person (other than a corporation)
 - (i) over whom the corporation has control;
 - (ii) who has control over the corporation; or
 - (iii) who is under the control of the same person as is the corporation; or
- (c) a partnership in which the corporation or its associate is a partner.

Where the payer and the recipient are both taxpayers qualifying for the concessionary tax regime, there would be no tax arbitrage and s.16(1A) would have no application. Hence, s.16(1A) will not be invoked to restrict deduction of management fees paid by a QAL to a connected QALM for qualifying aircraft leasing management services provided as their profits are assessed at half tax rate (DIPN 54, para. 82).

Example 5 (Adapted from DIPN 54, Example 11)

Qualifying Aircraft Lessor-HK leased an aircraft to Aircraft Operator-HK which was a connected person. The lease payment charged by Qualifying Aircraft Lessor-HK for

the year of assessment 2017/18 was \$12 million. Qualifying Aircraft Lessor-HK had not claimed depreciation allowances in respect of the aircraft before and elected for the half rate concession. Its operating expenses amounted to \$7 million for that year.

Profits tax payable by Qualifying Aircraft Lessor-HK

$$= (\$12,000,000 - \$7,000,000) \times 20\% \times 8.25\%$$

$$= \$1,000,000 \times 8.25\%$$

$$= \underline{\underline{\$82,500}}$$

Reduction in the profits tax payable by Qualifying Aircraft Lessor-HK

$$= (\$1,000,000 \times 16.5\%) - \$82,500$$

$$= \underline{\underline{\$82,500}}$$

Amount of the lease payment deductible by Aircraft Operator-HK

$$= \$12,000,000 - (\$82,500 \div 16.5\%)$$

$$= \underline{\underline{\$11,500,000}}$$

5.9.7 Deeming provision in s.15(1)(n)

With effect from 7 July 2017, gains or profits (other than those arising from the sale of capital assets) received by or accrued to a corporation from its aircraft leasing business or aircraft leasing management business in Hong Kong, would be deemed profits chargeable to tax in Hong Kong, notwithstanding that the aircraft concerned is used outside Hong Kong.

Example 68 Page 212

In part (a) of the solution, under alternative 2, revise the tax rate of 16.5% to 8.25%, the profits tax payable of \$39,600 to \$19,800, and \$24,750 to \$12,375.

In part (b) of the solution, revise the tax rate from 16.5% to 8.25%, the profits tax payable of \$132,000 to \$66,000, and \$82,500 to \$41,250.

New section 9.4.9 Page 250

Add a new section 9.4.9 and a new example 92a after section 9.4.8:

9.4.9 Aircraft subsequently used in another trade, profession or business to produce chargeable profits: ss.37(2B)–(2D) and ss.39B(6A)–(6C)

When an aircraft previously owned and used by a corporation for carrying out a qualifying aircraft leasing activity is subsequently used by the corporation in another trade, profession or business to produce chargeable profits, no initial allowance is granted as no capital expenditure is incurred. Annual allowance is to be computed based on the deemed cost of the aircraft. The deemed cost is computed by deducting from the actual cost of the aircraft the notional annual allowances for the period during which the aircraft was owned and used by the corporation for carrying out a qualifying aircraft leasing activity in respect of which the half rate concession applies, as if such annual allowances had been available to the corporation since it acquired the aircraft.

Example 92a (Adapted from DIPN 54, Example 11)

Qualifying Aircraft Lessor-HK acquired an aircraft at a consideration of \$300 million and used it for carrying out a qualifying aircraft leasing activity in Year 1 and Year 2 where half rate concession was granted. In Year 3, Qualifying Aircraft Lessor-HK ceased the aircraft leasing business and became dormant. In Year 4, it started an air transportation business and used the aircraft for such purpose.

S.39B(6B) would apply since the aircraft has been used by Qualifying Aircraft Lessor-HK for carrying out a qualifying aircraft leasing activity in respect of which the half rate concession applied before being used in the air transportation business.

Therefore, depreciation allowances of the aircraft for Year 4 would be computed as follows:

	\$
Acquisition cost	300,000,000
Less: Notional AA for Year 1	90,000,000
	<u>210,000,000</u>
Less: Notional AA for Year 2	63,000,000
	<u>147,000,000</u>
Less: Notional AA for Year 3	44,100,000
	<u>102,900,000</u>
Less: AA for Year 4	30,870,000
	<u><u>72,030,000</u></u>

Original section 9.4.9 **Renumber section 9.4.9 Assets removed from the pool for non-business use: s.39C(3) as section 9.4.10.**

Page 250

Original section 9.4.10 **Renumber section 9.4.10 Miscellaneous provisions as section 9.4.11.**

Page 250

Original section 9.4.11 **Renumber section 9.4.11 Assets used in the Mainland by cross-border processing businesses as section 9.4.12.**

Page 255

Section 13.6 **Under section 13.6 Unabsorbed loss from normal and concessionary trading receipts, replace the two paragraphs with the following paragraphs:**

Page 280

Sections 19CA and 19CB provide for the cross set off of unabsorbed losses from profits taxed at the normal rates and profits taxed at the concessionary rates specified in s.14A (i.e. QDIs), s.14B (i.e. qualifying reinsurance business of a professional reinsurer and qualifying insurance business of an authorised captive insurer), s.14D (i.e. qualifying profits of a CTC), s.14H (i.e. qualifying profits derived from qualifying aircraft leasing activity carried on by a qualifying aircraft lessor), or s.14J (i.e. qualifying profits derived from qualifying aircraft leasing management activity carried on by a qualifying aircraft leasing manager). For this purpose, profits or loss derived from normal trading receipts ('NTR') are referred to as 'normal profits or loss', and profits or loss derived from concessionary trading receipts ('CTR') are referred to as 'concessionary profits or loss'.

As these five streams of profits are taxed at different rates, it is necessary to apply an adjustment factor ('AF') to the profits or loss to be set off. The adjustment factor is the ratio the concessionary tax rates bear to the normal tax rates, which is 2 (i.e. 8.25%/16.5% for corporations; 7.5%/15% for persons other than corporations).

Section 14.5.3	Under section 14.5.3 Double tax arrangements with other countries, replace the second paragraph with the following:
Page 300	The Avoidance of Double Taxation on shipping services income is also covered by the comprehensive DTAs signed by the Hong Kong Government. As of 1 June 2018, Hong Kong has concluded comprehensive DTAs with 40 jurisdictions including Austria, Belarus, Belgium, Brunei, Canada, the Czech Republic, Finland, France, Guernsey, Hungary, India, Indonesia, Ireland, Italy, Japan, Jersey, Korea, Kuwait, Latvia, Liechtenstein, Luxembourg, the mainland of China, Malaysia, Malta, Mexico, the Netherlands, New Zealand, Pakistan, Portugal, Qatar, Romania, Russia, Saudi Arabia, South Africa, Spain, Switzerland, Thailand, the United Arab Emirates, the United Kingdom and Vietnam.
Section 14.6.2	Under section 14.6.2 Double tax arrangements on international aviation income, replace the last paragraph with the following:
Page 305	The Avoidance of Double Taxation on air services income is also covered by the comprehensive DTAs signed by the Hong Kong Government. As of 1 June 2018, Hong Kong has concluded comprehensive DTAs with 40 jurisdictions including Austria, Belarus, Belgium, Brunei, Canada, the Czech Republic, Finland, France, Guernsey, Hungary, India, Indonesia, Ireland, Italy, Japan, Jersey, Korea, Kuwait, Latvia, Liechtenstein, Luxembourg, the mainland of China, Malaysia, Malta, Mexico, the Netherlands, New Zealand, Pakistan, Portugal, Qatar, Romania, Russia, Saudi Arabia, South Africa, Spain, Switzerland, Thailand, the United Arab Emirates, the United Kingdom and Vietnam.
Topic recap Page 372	In item 5, add ss.14H and 14J to the list of 'Concessionary trading receipts chargeable at half of the tax rate'.
Topic recap Page 375	Under 'Partnerships', replace '16.5% on share of profits of corporate partner' by '8.25% or 16.5% on share of profits of corporate partner', and 'Standard rate on balance of profits' by '7.5% or 15% on balance of profits'.
Further reading Page 402	Add 'DIPN 54 Taxation of Aircraft Leasing Activities' at the end of the list of primary references.
Answers to exam practice questions Pages 927 and 928	New Happy Inn – under part (e), replace the first sentence of the last paragraph with the following: By virtue of ss.15(1)(b) and 21A, J Co will therefore be subject to profits tax on 30% of the royalty income earned during the year under review, at 8.25% (for the first \$2 million profits) and 16.5% (for profits over \$2 million).

Chapter 4 Non-resident persons
Section 4 Under section 4 Avoidance of double taxation, replace the sentence after 'Topic highlights' with:
Page 431

As of 1 June 2018, Hong Kong has signed 39 comprehensive double taxation agreements and arrangements ('DTAs').

Replace the third paragraph with the following:

The Avoidance of Double Taxation on shipping and air services income is also covered by the comprehensive DTAs signed by the Hong Kong Government. As of 1 June 2018, Hong Kong has concluded comprehensive DTAs with 40 jurisdictions including Austria, Belarus, Belgium, Brunei, Canada, the Czech Republic, Finland, France, Guernsey, Hungary, India, Indonesia, Ireland, Italy, Japan, Jersey, Korea, Kuwait, Latvia, Liechtenstein, Luxembourg, the mainland of China, Malaysia, Malta, Mexico, the Netherlands, New Zealand, Pakistan, Portugal, Qatar, Romania, Russia, Saudi Arabia, South Africa, Spain, Switzerland, Thailand, the United Arab Emirates, the United Kingdom and Vietnam.

Topic recap Under 'Topic recap', under the column 'Double Taxation Agreements (DTAs)',
Page 432 replace '37 comprehensive' with '39 comprehensive'.

Chapter 5 Hong Kong salaries tax
Topic list Add the following section to the topic list:
Page 441 5.10 Deduction of qualified premium for eligible health insurance products

Section 5.7 Update the table in section 5.7 Elderly residential care expenses, on page 469 as follows:
Page 469

Year of assessment	Deduction ceiling for elderly residential care expenses (per qualified parent or grandparent)
Before 2011/12	\$60,000
2011/12	\$72,000
2012/13 and 2013/14	\$76,000
2014/15 and 2015/16	\$80,000
2016/17 and 2017/18	\$92,000
2018/19 onwards	\$100,000

New section 5.10 Add a new section 5.10 after section 5.9 on page 472 as follows:
Page 472

5.10 Deduction of qualified premium for eligible health insurance products

The 2018/19 Budget proposed to introduce a tax deduction of qualified premium for eligible health insurance products under the Voluntary Health Insurance Scheme ('VHIS'). The annual tax ceiling of premium for tax deduction is \$8,000 per insured person. This measure will be implemented from the year of assessment following the passage of the relevant legislative amendments. Details of such a deduction have yet to be announced.

The Inland Revenue (Amendment) (No. 4) Bill 2018 was published by the IRD on 18 May 2018 which provides a tax deduction under salaries tax and personal assessment to people who purchase eligible health insurance products for themselves or their specified relatives under the VHIS.

Specified relatives cover the taxpayer's spouse and children, and the taxpayer's or his/her spouse's grandparents, parents and siblings.

If a taxpayer has procured more than one VHIS policy, the taxpayer may still claim deduction for the premiums paid, subject only to the \$8,000 cap for each insured person.

There is no cap on the number of taxpayers who can make a claim for tax deduction for the same insured person.

Section 6
Table
Page 474

Modify the following in the table of personal allowances for 2018/19 in section 6:

Under the 2018/19 Budget, all personal allowances remain unchanged with the exception of child allowance, and dependent parent/grandparent allowances. A new allowance named 'personal disability allowance' is added starting from the year of assessment 2018/19. The proposed changes are as follows:

	2017/18 \$	2018/19 Budget \$
Child allowance – 1st to 9th (each)	100,000	120,000
New born child (each)	100,000	120,000
Dependent parent/grandparent allowance – for parent aged 60 or more* (each)	46,000	50,000
Dependent parent/grandparent allowance – for parent aged between 55 and 59 (each)	23,000	25,000
Additional dependent parent/grandparent allowance – for parent aged 60 or more* (each)	46,000	50,000
Additional dependent parent/grandparent allowance – for parent aged between 55 and 59 (each)	23,000	25,000
Personal disability allowance	N/A	75,000

Section 6
Page 478

Add the following for the newly introduced personal disability allowance at the end of the table in section 6 on page 478:

Allowance	Scope	Conditions
Personal disability allowance	Taxpayer himself/herself	If a taxpayer is eligible to claim an allowance under the Government's Disability Allowance Scheme, he/she can claim this newly introduced personal disability allowance.

Section 7.3 **Modify the progressive tax rate table in section 7.3 on page 479 for 2017/18**
Page 479 **and add a new tax rate table for 2018/19:**

2017/18

First \$45,000	2.0%
Next \$45,000	7.0%
Next \$45,000	12.0%
Balance	17.0%

2018/19

First \$50,000	2.0%
Next \$50,000	6.0%
Next \$50,000	10.0%
Next \$50,000	14.0%
Balance	17.0%

Section 7.3 **Modify the following in the partial tax relief table for salaries tax and**
Page 480 **personal assessment under section 7.3 on page 480:**

	2016/17	2017/18
% of final tax reduction	75%	75%
Maximum limit	20,000	30,000

Chapter 7 **Personal assessment**

Section 2.2 **Add the following at the end of section 2.2 on page 549:**

Page 549 The 2018/19 Budget proposed to relax the requirement for the election of personal assessment by allowing married persons the option to elect personal assessment separately starting from the year of assessment 2018/19.

Chapter 8 **Hong Kong stamp duty**

Section 2.1 **Under section 2.1 Chargeable instruments, replace the stamp duty payable**
Pages 572 **under Head 1(1) and Head 1(1A) with the following:**
and 573

Head	Stamp duty
1(1)	1.5% – 15% (Part 1 and Part 2 of Scale 1 rates); or \$100 or 1.5% – 4.25% (Scale 2 rates); on the higher of the consideration and market value
1(1A)	1.5% – 15% (Part 1 and Part 2 of Scale 1 rates); or \$100 or 1.5% – 4.25% (Scale 2 rates); on the higher of the consideration and market value

Example 4 Replace the last paragraph with the following:

Page 580

The deed of gift is the chargeable instrument. As the property is a non-RPPT, AVD at Part 2 of Scale 1 rates will be payable based on the market value on the date of transfer, \$5.3 million at 6%, i.e. \$318,000.

Section 3.1.1 Under section 3.1.1 Rates of *Ad Valorem* Duty (AVD), add the following

Page 580

paragraphs before the last paragraph:

The Stamp Duty (Amendment) Ordinance 2018 was gazetted on 19 January 2018. With effect from 5 November 2016, Scale 1 AVD rates are divided into Part 1 and Part 2. The rates at Scale 1 are as follows:

Part 1 of Scale 1: a flat rate of 15% of the consideration or value of the property, whichever is the higher.

Part 2 of Scale 1 (original Scale 1 rates of 1.5% – 8.5%):

Consideration/market value	Rates at Scale 1 (Part 2)
Up to \$2,000,000	1.5%
\$2,000,001 – \$2,176,470	\$30,000 plus 20% of the excess over \$2,000,000
\$2,176,471 – \$3,000,000	3%
\$3,000,001 – \$3,290,330	\$90,000 plus 20% of the excess over \$3,000,000
\$3,290,331 – \$4,000,000	4.5%
\$4,000,001 – \$4,428,580	\$180,000 plus 20% of the excess over \$4,000,000
\$4,428,581 – \$6,000,000	6%
\$6,000,001 – \$6,720,000	\$360,000 plus 20% of the excess over \$6,000,000
\$6,720,001 – \$20,000,000	7.5%
\$20,000,001 – \$21,739,130	\$1,500,000 plus 20% of the excess over \$20,000,000
Over \$21,739,130	8.5%

Application of Part 1 of Scale 1

Unless specifically exempted or otherwise provided, Part 1 of Scale 1 applies to an AFS for the acquisition of any RPPT executed on or after 5 November 2016, and to the COS of such a property executed on or after that date (unless the related AFS was executed before 5 November 2016). However, Part 1 of Scale 1 does not apply to an AFS/COS for a RPPT where the purchaser/transferee is a HKPR (or he is a tenant or an authorized occupant of the Housing Authority who acquires the RPPT under the Tenants Purchase Scheme) acting on his own behalf and does not own any other RPPT in Hong Kong at the time of acquisition of the subject property, irrespective of whether the purchaser/transferee is acquiring a RPPT for the first time. Only the lower rates (Scale 2) will apply to such AFS/COS.

Application of Part 2 of Scale 1

Unless specifically exempted or otherwise provided, Part 2 of Scale 1 applies to an AFS for the acquisition of any RPPT executed on or after 23 February 2013 but before 5 November 2016; and to an AFS for the acquisition of any non-RPPT executed on or after 23 February 2013.

Section 3.1.2 **Under section 3.1.2 Partial refund of AVD, add the following paragraph after the last paragraph:**
Page 581

For HKPRs who change their RPPT and wish to claim partial refund of the AVD paid on acquisition of the new RPPT, the Stamp Duty (Amendment) Ordinance 2018 also extends the time limit for the disposal of the original RPPT from within 6 months to within 12 months after the date of conveyance of the new RPPT if the new RPPT is acquired on or after 5 November 2016.

New section **Add a new section 3.1.3 after section 3.1.2 on page 581:**
3.1.3
Page 581

3.1.3 Acquisition of more than one residential property under one single instrument

On 11 April 2017, the Government announced that the SDO would be amended to tighten up the existing exemption arrangement for HKPR. Subject to enactment of the relevant legislation, unless specifically exempted or otherwise provided, all instruments executed on or after 12 April 2017 for the sale and purchase or transfer of more than one RPPT under one single instrument will be subject to AVD at a flat rate of 15%, even if the purchaser/transferee is a HKPR who is acting on his/her own behalf and is not a beneficial owner of any other RPPT in Hong Kong at the time of acquisition.

Before the proposed legislation is enacted, instruments chargeable with AVD at the proposed new AVD rate will be stamped by reference to Scale 1 rates or Scale 2 rates (as the case may be) first. The additional AVD, representing the difference between AVD payable at the proposed new AVD rate and Scale 1 rates or Scale 2 rates (as the case may be), will have to be paid within 30 days commencing immediately after the date of gazettal of the enacted legislation.

Example 8 **Replace the second last sentence in the last paragraph with the following:**
Page 584

AVD at Part 2 of Scale 1 rates is payable on \$9 million at 7.5%, i.e. \$675,000.

Example 9 **Add the following paragraph after the last paragraph:**
Page 584

If the RPPT was purchased on 1 March 2018, the flat rate of 15% under Part 1 of Scale 1 will apply. The AVD payable will then be \$1,500,000 (\$10 million × 15%).

New Example **Add the following example after Example 9:**
9a
Page 584

Example 9a

On 1 March 2018, a HKPR entered into an AFS to purchase a RPPT for \$22 million. At the time of acquisition, the HKPR did not own any other RPPT in Hong Kong. On 1 April 2018, his spouse, who already owned an RPPT in Hong Kong, was added in the assignment as one of the joint owners of the property.

As the HKPR does not own any other RPPT in Hong Kong, AVD at Scale 2 rates is payable on the AFS under Head 1(1A) on \$22 million at 4.25%, i.e. \$935,000.

Notwithstanding that the spouse already owned an RPPT in Hong Kong, AVD at Scale 2 rates is payable on the assignment, which is computed by reference to the stated consideration or the value of the property, whichever is the higher, less part of the SD representing the share of the interest of the HKPR in the property. Therefore, AVD payable is \$467,500 (\$22 million × 4.25% × 50%).

If the spouse does not own any other RPPT in Hong Kong, nomination of a close relative who does not own any other RPPT in Hong Kong will not attract any AVD. The assignment will be charged with a fixed duty of \$100 only under Head 1(1).

Example 10 **Replace the last sentence in the first paragraph with the following:**

Page 585 AVD at Part 2 of Scale 1 rates will be imposed on:

Example 11 **Replace the first sentence in the first paragraph with the following:**

Page 585 In 2017, A signed an AFS to purchase a non-RPPT from B at \$5 million, and AVD at Part 2 of Scale 1 rates on the AFS was charged at 6% on \$5 million.

Replace the last paragraph with the following:

If, instead of admitting his parent, spouse and child, A admitted his two friends B and C as joint owners, further AVD at Part 2 of Scale 1 rates will be payable on the COS in the amount of \$200,000 ($\$5 \text{ million} \times 6\% \times 2/3$).

New Example **Add the following example after Example 16:**

16a

Example 16a

Page 591

Same as Example 16, except that the RPPT transactions all took place in 2018.

Solution

As Mr. L and Mr. M are HKPRs and do not own any other RPPT in Hong Kong, AVD at Scale 2 rates is payable on the PAFS under Head 1(1A) on \$6 million at 3%, i.e. \$180,000.

As Mr. N is a non-HKPR and is not a close relative of Mr. L nor Mr. M, AVD at Part 1 of Scale 1 rate of 15% is payable on the AFS under Head 1(1A) on Mr. N's share of interest ($\$6 \text{ million} \times 1/3$), i.e. \$300,000.

The amount of SSD and BSD payable, and stamp duty on the deed of assignment remain the same, i.e. \$400,000, \$900,000 and \$100 respectively.

Example 22 **Replace the first sentence in the first paragraph with the following:**

Page 596 On 1 April 2018, X signed an AFS to sell an office to Y.

Replace the second last sentence in the last paragraph with the following:

The AFS is dutiable under Head 1(1A), and the AVD at Part 2 of Scale 1 rates is \$562,500 ($\$7.5 \text{ million} \times 7.5\%$).

New Example **Add the following example after Example 24:**

24a

Example 24a

Page 601

Same as Example 24, except that the RPPT was purchased on 1 February 2017 and Connie assigned her one-third share in the property on 1 July 2018.

Solution

Since the assignment of Connie's share in the property is executed after 5 November 2016, AVD at Part 1 of Scale 1 rate of 15% is payable, i.e. \$240,000 ($\$1,600,000 \times 15\%$).

The amount of SSD and BSD payable remains the same, i.e. \$160,000 and \$240,000 respectively.

Answer 5
Page 631

Replace the second sentence in the first paragraph under part (c) with the following:

The AFS is chargeable with AVD at Part 1 of Scale 1 rate of 15% (for RPPT) or Part 2 of Scale 1 rates (for non-RPPT) under Head 1(1A) on the higher of the consideration and market value of the property.

Answers to exam practice questions
Page 961

Mr. Pang – under part (a), replace the second sentence of the first paragraph with the following:

The conveyance will be chargeable to AVD at Part 2 of Scale 1 rates under Head 1(1) on the market value of Property A.

Answers to exam practice questions
Pages 967 and 968

E Ltd – under part (a), replace the first paragraph and the first sentence of the second paragraph with the following:

The agreement for sale ('AFS') executed between E Ltd and F Ltd on 1 February 2017 is chargeable with ad valorem duty ('AVD') at Part 2 of Scale 1 rates under Head 1(1A) in the First Schedule.

The AFS executed between E Ltd and G Ltd on 15 July 2017 is again chargeable with AVD at Part 2 of Scale 1 rates under Head 1(1A).

E Ltd – under part (c), replace the first sentence of the second paragraph with the following:

Provided that the AFS is duly stamped, the assignment executed on 1 April 2017 will be chargeable with AVD at Scale 2 rates under Head 1(1) by reference to the consideration less a fraction of the AVD representing the proportion of the flat that is vested in Mr. K (i.e. 1/2) (s.29D(4)).

Answers to exam practice questions
Page 969

Anomalistic Ltd – under part (a), replace the first sentence of the second paragraph with the following:

As Property X is a commercial property, the transfer is subject to Part 2 of Scale 1 rates under Head 1(1) or Head 1(1A).

Anomalistic Ltd – under part (c), replace the last sentence of the second paragraph with the following:

The AVD is therefore \$2,400,000 (\$16,000,000 × 15%) in accordance with Part 1 of Scale 1 rates under Head 1(1) (para. 39, SOIPN No. 8).

Chapter 9 Introduction to tax planning

Topic list
Page 643

Add the following section to the Topic list:

4.7 Section 14M – Aircraft leasing tax concessions: anti-avoidance provisions

Section 4
Page 651

Under section 4 Anti-avoidance provisions under the IRO, add the following section after s.9A in the table:

Section	Scope	Enforced by
14M	Aircraft leasing tax concessions: anti-avoidance provisions	Not specified

New section 4.7 Add a new section 4.7 after section 4.6:

4.7

Page 664

4.7 Section 14M – Aircraft leasing tax concessions: anti-avoidance provisions

S.14M was enacted on 7 July 2017 to ensure that the chargeable profits from a transaction between a qualifying aircraft lessor ('QAL') and its associate in connection with a qualifying aircraft leasing activity should be determined by reference to the amount of profits that would have accrued had the same transaction been carried out at arm's length terms between parties who are not associates (ss.14M(1) and (2)). This arm's length principle also applies to a qualifying aircraft leasing management activity between a qualifying aircraft leasing manager ('QALM') and its associate (ss.14M(3) and (4)).

Ss.14M(1) to (4) sets out the conditions where the profits in respect of transactions in connection with a qualifying aircraft leasing activity or a qualifying aircraft leasing management activity between a qualifying entity and its associates may be subjected to adjustment.

Where a QAL defeases an aircraft owned via a funding lease, a hire-purchase agreement or a conditional sale agreement to a third party, the QAL is no longer obliged to make payments under such ownership arrangement, and the QAL would be treated as if it had ceased to own the aircraft. Hence, no profits tax concessions will be granted to the QAL in respect of the leasing transaction with the aircraft operator as it is no longer a qualifying aircraft leasing activity as defined in s.14G(6) (s.14M(5)).

Application of this provision is also discussed in Chapter 3, section 5.9.5 on 'Anti-avoidance provisions in s.14M'.

Example 26 Under Stamp duty implications, replace the first sentence in the first paragraph with the following:
Page 701

As the residential property (RPPT) is located in Hong Kong, the agreement for sale and purchase (AFS) of the RPPT will be liable to AVD at Part 1 of Scale 1 rates under Head 1(1A) of the SDO at the rate of 15% on the higher of the consideration or the unencumbered value of the RPPT.

Chapter 12 Double taxation arrangements and agreements

Topic list Add the following section to the topic list:

Page 817 4.6 Transfer pricing documentation and Country-by-Country Reporting

Learning focus Replace the first sentence of the Learning focus on page 817 with the following:

Page 817 As of 1 June 2018, Hong Kong has signed 40 comprehensive double taxation arrangements and agreements.

Section 1.1 Replace the last paragraph in section 1.1 on page 820 with the following:

Page 820 As of 1 June 2018, Hong Kong has signed 40 comprehensive DTAs, including Belgium, Thailand, the mainland of China, Luxembourg, Vietnam, Brunei, the Netherlands, Indonesia, Hungary, Kuwait, Austria, the United Kingdom, Ireland, Liechtenstein, France, Japan, New Zealand, Switzerland, Portugal, Spain, the Czech Republic, Malta, Jersey, Malaysia, Mexico, Canada, Italy, Guernsey, Qatar, Korea, South Africa, United Arab Emirates ('UAE'), Romania, Russia, Latvia, Belarus, Pakistan, Saudi Arabia, India and Finland.

Section 4.3.3 **Replace the second last paragraph in section 4.3.3 on page 841 with the following:**
Page 841

As of 1 June 2018, Hong Kong signed CAAs with 15 jurisdictions including Belgium, Canada, Guernsey, Indonesia, Ireland, Italy, Japan, Korea, Mexico, the Netherlands, New Zealand, Portugal, South Africa, Switzerland and the United Kingdom.

Section 4.3.3 **Add the following after the last paragraph in section 4.3.3 on page 841:**
Page 841 **Inland Revenue (Amendment) (No. 2) Ordinance 2017**

The Inland Revenue (Amendment) (No. 2) Ordinance 2017 was gazetted on 16 June 2017 and came into effect from 1 July 2017.

From 1 July 2017, the list of 'reportable jurisdictions' under the Inland Revenue Ordinance has been expanded to cover 75 jurisdictions, comprising those confirmed AEOI partners and prospective AEOI partners. The prospective AEOI partners include the following three categories:

- (a) Jurisdictions which have expressed an interest in conducting AEOI with Hong Kong or jurisdictions suggested by the OECD;
- (b) Hong Kong's tax treaty partners which have committed to AEOI; and
- (c) All member states of the EU.

With effect from 3 July 2017, AEOI Portal has been launched for financial institutions to furnish notifications and file returns in relation to the reporting of financial account information for AEOI purposes.

Financial Institutions have to register under the AEOI Portal in order to use the online services. Financial institutions maintaining reportable accounts on or before 3 July 2017 are required to register under the AEOI Portal and submit a notification of commencement of maintaining reportable accounts no later than 3 October 2017. Financial institutions who commence to maintain any reportable accounts after 3 July 2017 should submit the required notifications through the AEOI Portal within three months from the commencement of maintaining such accounts.

Inland Revenue (Amendment) (No. 5) Bill 2017

The Inland Revenue (Amendment) (No. 5) Bill 2017 was gazetted on 6 October 2017. This Amendment Bill seeks to pave the way for Hong Kong's participation in the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, and to align the IRO with the CRS promulgated by the OECD.

The Multilateral Convention is an important platform for Hong Kong to implement AEOI and combat base erosion and profit shifting.

Currently, the IRO does not give effect to multilateral tax agreements or arrangements for international tax co-operation other than providing relief from double taxation and exchange of information. This Amendment Bill aims to remove the limitation so as to facilitate Hong Kong's participation in multilateral tax agreements and new areas of international tax co-operation.

Furthermore, this Amendment Bill makes necessary legislative amendments to align the IRO with the CRS by removing inconsistencies identified.

Inland Revenue (Amendment) Ordinance 2018

The Inland Revenue (Amendment) Ordinance 2018 was gazetted on 2 February 2018. The technical amendments on AEOI (i.e. clauses 5 to 11) under the (Amendment) Ordinance 2018 will come into operation on 1 January 2019 while other provisions take effect on 2 February 2018.

The (Amendment) Ordinance 2018 provides the legal framework for Hong Kong to implement multilateral tax arrangements and thereby allows more effective implementation of the arrangements relating to AEOI as well as automatic exchange of country-by-country reports and spontaneous exchange of information on tax rulings under the BEPS package.

The (Amendment) Ordinance makes technical amendments to certain provisions (i.e. clauses 5 to 11) on AEOI so as to align them with the CRS promulgated by the OECD.

These amendments do not make substantial changes to the due diligence requirements for reporting FIs. However, considering that reporting FIs will take time to fine-tune their systems and mode of operation in order to implement the refinements, such provisions will only become effective on 1 January 2019. In other words, the existing AEOI provisions will continue to apply to FIs' reports for 2018 which will be due for submission in mid-2019. The refined provisions under the (Amendment) Ordinance will apply to FIs' reports for 2019 which will be due for submission in mid-2020 and thereafter.

The scope of information to be exchanged, either conducted on a bilateral basis or under the Multilateral Convention, would generally be the same. The (Amendment) Ordinance does not alter the high level of privacy and confidentiality safeguards currently applicable to the handling of tax information under the IRO.

The (Amendment) Ordinance allows Hong Kong to implement the new initiatives on international tax co-operation more effectively and reduces the risk of Hong Kong being identified as a 'non-cooperative tax jurisdiction'.

Section 4.5 **Add the following after the last paragraph of section 4.5 on page 843:**

Page 843

The Inland Revenue (Amendment) (No. 6) Bill 2017 was gazetted on 29 December 2017. The main objectives are to codify the transfer pricing principles into the IRO and implement the minimum standards of the BEPS Action Plans promulgated by the OECD.

The Bill proposes a statutory dispute resolution regime for effective and efficient resolution of disputes through Mutual Agreement Procedures and/or arbitration. This fulfills the requirements of BEPS Action 14 which calls for improving the cross-border dispute resolution mechanism.

The Bill also clarifies the double taxation reliefs available in the presence or in the absence of a tax treaty and proposes to extend the time limit for making fresh foreign tax credit claim from two years to six years after the end of the relevant year of assessment.

Implementing the BEPS Action Plans will demonstrate Hong Kong's commitment to combating cross-border tax evasion. This is vital for Hong Kong to preserve its competitiveness and reputation as an international financial and business centre.

Section 4.6 Add a new section 4.6 after section 4.5 on page 843:

Page 843

4.6 Transfer pricing documentation and Country-by-Country Reporting

The revised OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations recommends jurisdictions to adopt a three-tiered approach for transfer pricing documentation.

The three-tiered approach includes:

- A **Master File** with global information about a multinational group, including specific information on intangibles and financial activities. This would be made available to all relevant country tax administrations;
- A **Local File** with detailed information on all relevant material inter-company transactions of the particular group entity in each jurisdiction; and
- A **Country-by-Country (CbC) Report** of income, earnings, taxes paid and certain measures of economic activities.

The Inland Revenue (Amendment) (No. 6) Bill 2017 was gazetted on 29 December 2017 to implement key actions arising from BEPS project including transfer pricing documentation.

Salient points are as follows:

Master File and Local File

Mandatory contemporaneous transfer pricing documentation requirements are introduced by the Inland Revenue (Amendment) (No. 6) Bill 2017.

Preparation of Master File and Local File starting from the accounting period on or after 1 April 2018 for Hong Kong entities is required unless any one of the two exemptions are met.

The two exemptions are based on the size of the Hong Kong entity and the volume of related party transactions.

A Hong Kong entity which can satisfy any two of the following three conditions is exempted from the preparation of Master File and Local File:

- Total annual revenue of not more than \$200 million;
- Total assets of not more than \$200 million; and
- Average number of employees of no more than 100.

Furthermore, if the total amount of the following related party transaction does not exceed the respective threshold, Local Files are not required:

- Transfer of properties (other than financial assets and intangibles) – \$220 million;
- Financial asset transactions – \$110 million;
- Transfer of intangible assets – \$110 million; or
- Any other transactions – \$44 million.

If no Local File is required, the Hong Kong entity is not required to prepare the Master File.

The Master File and Local File are required to be prepared within six months after the end of each accounting year.

Country-by-Country (CbC) Report

CbC Report is a minimum standard formulated by the OECD under Action 13 of the BEPS Package.

The CbC Report requires aggregate tax jurisdiction-wide information relating to the global allocation of the income, the taxes paid, and certain indicators of the location of economic activity among tax jurisdictions in which a multinational enterprise group operates. The Report also requires a listing of all the constituent entities for which financial information is reported, including the jurisdiction of incorporation of each of the constituent entities (if different from the tax jurisdiction of residence) and the main business activities carried out by that entity.

CbC Reports are to be exchanged automatically between tax authorities under relevant exchange arrangements.

According to the Inland Revenue (Amendment) (No. 6) Bill 2017, a multinational enterprise group whose annual consolidated group revenue reaches HK\$6.8 billion is required to file a CbC Return, which includes a CbC Report.

If the ultimate parent entity is a resident in Hong Kong, it has the primary obligation to file a CbC Return for each accounting period beginning on or after 1 January 2018. The ultimate parent entity resident in Hong Kong may also voluntarily file a CbC Return for an accounting period beginning between 1 January 2016 and 31 December 2017.

If the ultimate parent entity is not a resident in Hong Kong, it is subject to a secondary obligation to file a CbC Return if any of the following conditions is met:

- The ultimate parent entity is not required to file a CbC Report in its jurisdiction of tax residence;
- The jurisdiction has a current international agreement with Hong Kong providing for automatic exchange of tax information. However, by the deadline for filing the CbC Return, there is no exchange arrangement in place between the jurisdiction and Hong Kong for CbC Reports;
- There has been a systemic failure to exchange CbC Reports by the jurisdiction, which has been notified to the group constituent entities resident in Hong Kong by the Commissioner.

The deadline for filing a CbC Return is 12 months after the end of the relevant accounting period or the date specified in the assessor's notice, whichever is the earlier.

Penalties would be imposed for non-compliance including failing to file CbC Returns and providing misleading, false or inaccurate information in CbC Returns.

At present, the Multilateral Convention is not applicable in Hong Kong. Hence, bilateral arrangements for the exchange of CbC Reports need to be made with jurisdictions having DTAs with Hong Kong. So far, Hong Kong has made such bilateral arrangements with the following jurisdictions:

Jurisdiction	Year for the first exchange of CbC Reports
France	2016
Ireland	2016
South Africa	2016
United Kingdom	2016

The Hong Kong Government will continue negotiation with other existing treaty partners and seeking to conclude as many bilateral arrangements as practicable.

Section 5 **Replace the second paragraph in section 5 on page 844 with the following:**

Page 844

In order to enhance Hong Kong as an investment platform and a gateway for inbound and outbound investments, Hong Kong has accelerated its treaty negotiations with other jurisdictions. As of 1 June 2018, Hong Kong has concluded comprehensive double taxation agreements with 40 jurisdictions including Belgium, Thailand, the mainland of China, Luxembourg, Vietnam, Brunei, the Netherlands, Indonesia, Hungary, Kuwait, Austria, the United Kingdom, Ireland, Liechtenstein, France, Japan, New Zealand, Switzerland, Portugal, Spain, the Czech Republic, Malta, Jersey, Malaysia, Mexico, Canada, Italy, Guernsey, Qatar, Korea, South Africa, United Arab Emirates (UAE), Romania, Russia, Latvia, Belarus, Pakistan, Saudi Arabia, India and Finland.

Modify the table in section 5 on page 844 as follows:

Country	CDTA/ Protocol	Gazetted	Came into force	Take effect
Latvia	CDTA	30 June 2017	24 Nov 2017	Y/A 2018/19
Belarus	CDTA	30 June 2017	30 Nov 2017	Y/A 2018/19
Pakistan	CDTA	30 June 2017	24 Nov 2017	Y/A 2018/19
Saudi Arabia	CDTA	In progress	Pending	Pending
India	CDTA	In progress	Pending	Pending
Finland	CDTA	In progress	Pending	Pending

Appendix 1 **Add the following to Appendix 1 'Summary of avoidance of double taxation agreements' on page 856:**
Page 856

DTA with Hong Kong	Withholding tax charged by the host country			Taxing right of the host country		Taxing right of capital gain on disposal of shares of	
	Dividend	Interest	Royalty	Shipping income	Airline income	Company's assets >50% are immovable property	Other companies
Saudi Arabia	5% ^(xvi)	0% ^(xvi)	5%/8% ^(xvi)	Exempted	Exempted	Both	< 10% shareholding – Home country 10% or more – Both
India	5% ^(xvi)	0%/10% ^(xvi)	10% ^(xvi)	Exempted	Exempted	Both	Both
Finland	5%/10% ^(xvi)	0% ^(xvi)	3% ^(xvi)	Exempted	Exempted	Both	Home country

Chapter 13 **Overview of China tax system**

Section 14.1 **Add the following after the last paragraph of section 14.1 on page 887:**

Page 887 ***Caishui [2017] No. 56***

Caishui [2017] No. 56 was promulgated on 30 June 2017 to clarify VAT issues in connection with the asset management sector.

Caishui [2017] No. 56 became effective from 1 January 2018.

VAT taxable activities during the operating period of asset management products are temporarily subject to VAT using the simplified method at a rate of 3% starting from 1 January 2018.

VAT taxable activities conducted during the operation of asset management products prior to 1 January 2018 would not be subject to VAT.

Section 22.2.1 **Add the following circular at the end of the fourth from last paragraph of section 22.2.1 on page 900, in connection with charitable donations:**

Page 900 ***Caishui [2018] No. 15***

Section 22.2.3 **Remove the last paragraph of section 22.2.3 on page 902 and add the following:**

Page 902 **Deferral of withholding tax on direct re-investment**

On 21 December 2017, the Ministry of Finance, the SAT, the National Development and Reform Commission and the Ministry of Commerce jointly issued *Caishui [2017] No. 88*.

Dividends derived by non-resident investors from China are subject to a PRC withholding tax of 10% unless such rate can be reduced by the applicable double taxation agreements. *Caishui [2017] No. 88* sets out the tax deferral treatment and encourages the non-resident investors to make direct re-investment to China.

Caishui [2017] No. 88 clarifies the criteria to enjoy tax deferral treatment, application procedures and responsibilities, and post-administration by the tax authorities.

Caishui [2017] No. 88 would be effective retrospectively from 1 January 2017, and tax payments already settled on eligible re-investment can be refunded.

Section 22.3.1 **Add the following after the last paragraph under 'Annual filing obligation' in section 22.3.1 on page 902:**

Page 902

The SAT promulgated *Public Notice [2017] No. 54* at the end of December 2017 introducing a new version of annual CIT return and the explanatory notes for completing the forms. *Public Notice [2017] No. 54* took effect from 1 January 2017 and shall apply to the annual CIT filing for 2017 and onwards.

The new package has been designed according to the new tax policies released since 2014. The new package is composed of 37 forms, including one basic information form, one lead return and 35 schedules.

Compared with the 2014 annual CIT return package, the overall structure of the new package has not changed significantly. The new package demonstrates the principle of 'simplified forms, optimized structure and facilitating reporting'. This demonstrates the tax authorities' principle of strengthening information collection and post-filing supervision.

Section 22.3.2 **Add the following after the last paragraph of section 22.3.2 on page 903:**

Page 903

The SAT promulgated *Public Notice [2017] No. 37* which became effective from 1 December 2017. According to *Public Notice [2017] No. 37*, the withholding obligation on dividend payment shall arise when the dividend payment is actually made.

Public Notice [2017] No. 37 also stipulated that when the payer (i.e. the withholding agent) fails to withhold taxes, the recipient (i.e. the non-PRC tax resident) should perform self-reporting and pay the related taxes to the tax authority.

Section 22.5.1 **Replace the following phrase in section 22.5.1 on page 905:**

Page 905

Replace *Public Announcement No. 30* with *Public Notice [2012] No. 30*.

Add the following after the last paragraph of section 22.5.1 on page 905:

The SAT released *Public Notice [2018] No. 9* on 3 February 2018 which abolished *Guoshuihan [2009] No. 601* and *Public Notice [2012] No. 30*.

Public Notice [2018] No. 9 made changes to unfavourable factors stated in *Guoshuihan [2009] No. 601*.

Public Notice [2018] No. 9 tightened the first two unfavourable factors, deleted the third and the fourth factors and retained the fifth to seventh factors stated in *Guoshuihan [2009] No. 601*.

The salient points of the above changes are as follows:

- The first unfavourable factor – The applicant has the obligation to pay more than 50% (the original threshold was 60% in *Guoshuihan [2009] No. 601*) of the income within 12 months following the receipt of the income to a third jurisdiction tax resident.
- The second unfavourable factor – The applicant does not carry out substantive business activities. Whether an applicant's business activities

are 'substantive' shall be assessed based on the function performed and risk undertaken by the applicant. Substantive business activities include manufacturing, trading and management activities as well as investment and management activities.

The explanatory notes to *Public Notice [2018] No. 9* provide guidance on the definition of investment and management activities including project analysis, pre-investment research, investment decision, execution, post-investment management, industry analysis, market research, regional headquarters function, treasury function, financing function, etc.

- The third and the fourth unfavourable factors in *Guoshuihan [2009] No. 601* are deleted as their assessment criteria have been incorporated into the new interpretation of the second unfavourable factor.

The above changes will pose challenges to some non-resident taxpayers as their treaty benefits may be denied for the lack of beneficial ownership.

Nevertheless, *Public Notice [2018] No. 9* has brought the following two major changes for claiming of tax treaty benefits on dividends:

- Extended the safe harbor rule with respect to dividends of listed companies to also cover governments and individuals who are tax residents of a tax treaty jurisdiction; or a company, directly or indirectly, wholly owned by the listed company, the aforementioned government or individuals; and
- Qualified treaty benefit applicants may apply a 'same jurisdiction/same treaty benefit rule' under multi-tier holding structures.

'Same jurisdiction rule' – The shareholder, which directly or indirectly holds 100% equity interest of the applicant, qualifies as a beneficial owner under *Public Notice [2018] No. 9* and the aforementioned shareholder and the applicant are tax residents of the same tax jurisdiction.

'Same treaty benefit rule' – The shareholder, which directly or indirectly holds 100% equity interest of the applicant, qualifies as a beneficial owner under *Public Notice [2018] No. 9* and such shareholder and all the intermediate shareholders in the multi-tier holding structure are tax residents from a jurisdiction which enjoys the same or better treaty benefits in connection with dividends received as compared to that which the applicant is entitled to.

The above changes will increase non-resident taxpayers' chances of enjoying treaty benefits on dividends.

Public Notice [2018] No. 9 takes effect from 1 April 2018 and *Guoshuihan [2009] No. 601* and *Public Notice [2012] No. 30* are then abolished.

**Section
22.5.2**

Replace the following phrase in the last paragraph of section 22.5.2 on page 906:

Page 906

Replace *Public Announcement [2015] No. 7* with *Public Notice [2015] No. 7*

Add the following after the last paragraph of section 22.5.2 on page 906:

Public Notice [2015] No. 7 also stipulated that the payers (i.e. the transferee), without distinguishing whether they are PRC tax resident enterprises or non-PRC resident enterprises, have a withholding obligation on PRC taxes arising from indirect equity transfers.

