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

By email (bc_07_20@legco.gov.hk) and by hand

29 April 2021

Our Ref.: C/TXG, M129849

Hon. Holden Chow Ho-ding
Chairman, Bills Committee on Inland Revenue (Amendment) (Miscellaneous Provisions) Bill 2021
Legislative Council Complex,
1 Legislative Council Road,
Central, Hong Kong

Dear Mr. Chow,

Re. Inland Revenue (Amendment) (Miscellaneous Provisions) Bill 2021

The Hong Kong Institute of Certified Public Accountants ("Institute") has reviewed the Inland Revenue (Amendment) (Miscellaneous Provisions) Bill 2021("the Bill") and we are generally in support of the main aims of the Bill. However, we have certain concerns regarding some of the detailed provisions, particularly in relation to Part 4 of the Bill, and would like to submit the views below for the Bills Committee's consideration.

Part 2

1. Amendments relating to qualifying amalgamations

While the legislation seeks to codify an existing administrative practice adopted by the Inland Revenue Department ("IRD"), there are issues with that practice which, we suggest, should be addressed in the legislation.

Utilisation of pre-amalgamation losses

- The introduction of court-free amalgamation into the Companies Ordinance (Cap. 622) was intended to provide an easier option for corporate groups to internally restructure and streamline their businesses. However, as specific anti-avoidance provisions (i.e. good commercial reasons, and main purposes test) are introduced in the Bill, on top of the general anti-avoidance provision in the existing section 61A of the Inland Revenue Ordinance (Cap. 112 ("IRO")), the other requirements are unduly restrictive and create an additional burden for taxpayers undergoing genuine corporate restructuring.

  For instance, the "financial resources condition" requires the amalgamated company to demonstrate that it has adequate financial resources (excluding any loan from an associated corporation) immediately before the amalgamation to purchase the trade or business carried on by the amalgamating company. However, currently, there are no similar provisions in the IRO preventing a loss company from obtaining

37th Floor, Wu Chung House,
213 Queen's Road East, Wanchai, Hong Kong
香港灣仔皇后大道東213號胡忠大廈37樓
Tel電話: (852) 2287 7228
Fax傳真: (852) 2865 6776
(852) 2865 6603
Website網址: www.hkicpa.org.hk
Email電郵: hkicpa@hkicpa.org.hk

financing from a group company to acquire a profitable business.

- The "same trade condition" gives rise to a lot of uncertainties as to what amounts to "same trade". Also, the amalgamated company will need to keep track of and separately account for the profits or losses of the trade or business succeeded from the amalgamating company after the amalgamation, which could defeat the commercial purpose of an amalgamation (in terms of simplifying matters).

Stamp duty implications of corporate amalgamations

- Legislative change or guidance should be issued to deal with the potential stamp duty issues arising from corporate amalgamations.

Merger of two Hong Kong branches

- Consideration should be given to allowing Hong Kong branches of foreign companies merged under the merger laws of foreign countries to elect for Schedule 17J.

Part 4

2. Amendments relating to furnishing of tax returns

Introduction of electronic-filing of tax returns ("e-filing")

- We are broadly supportive of early moves towards the introduction of e-filing and we have raised this with the Administration on several occasions. E-filing is commonplace in many jurisdictions around the world, albeit at different stages of full digitalisation and, in this respect, with the existing, fairly rudimentary e-tax system, Hong Kong is lagging behind.

- At the same time, we have concerns that the Bill is setting out a framework for e-filing, including roles and responsibilities, as well liabilities of different parties before there has been any detailed discussion or consultation on how the system will operate. We think this is premature and seems to be putting the cart before the horse. A comprehensive system of e-filing which, under the legislation, could be made mandatory represents a major operational change to the process for furnishing tax returns, which, we believe merits a broader public consultation. Given the proposed timetable for implementing e-filing, there ought to be sufficient time to introduce legislation once more detailed plans for system design, structure and operation have been worked out. Under the circumstances, we would ask that this part of the Bill be deferred for the being. We outline some of our more specific concerns below.

Specific concerns

- The provisions on the engagement of a service provider ("SP"):

- Generally, the intention and purpose behind the provisions on SPs are not clear.

- The circumstances under which an SP could be engaged are not entirely clear, i.e., under the proposed section 51AAD(1) of the IRO – "A taxpayer may, in a case specified by the Commissioner, engage a service provider to furnish a return under section 51(1) for or on behalf of the taxpayer". There is no indication of the cases, or types of cases, that will be specified by the Commissioner. For example, there is uncertainty whether this statutory arrangement might be implemented to replace the existing system for filing paper returns whereby returns may be submitted by a tax representative. There would be a concern if this were so because the existing system has worked smoothly for many years without, to our knowledge, any major issues arising.

- The roles that the legislation envisages an SP will perform need to be further clarified. Is it envisaged, for example, that the key roles of an SP will be e-signing and submitting a return and supporting documents, or that an SP will perform the role currently played by a tax representative in relation to paper returns?

- We have strong reservations regarding penalty provisions under the proposed section 80K of the IRO. If it is assumed that an SP will perform the role of a tax representative (which is itself not entirely clear, as indicated above), our members expressed serious concerns about the suggestion that there would potential penalties for tax return and computation preparers under the e-filing system tax, in the context of commenting on the IRD's proposed "taxonomy package" on the format of e-filing for financial statements and tax computations. The point was made that tax representatives prepare the tax returns and computations in good faith based on the information and documents provided by their clients and, currently, do not have any obligation to verify the correctness of the information and documents. Under the current paper-based filing system, they may face penalties only if they, e.g., aid, abet or incite another person to commit an offence, as set out under section 80(4) of the IRO. While it may add some technological complexity, changing over to e-filing system from paper-based filing, in effect, changes only the mode of submission and, therefore, should not lead to a different penalty exposure. Our understanding is that it is not the norm overseas to provide for such penalties tax agents. In other jurisdictions that are further advanced than Hong Kong in terms of e-filing, some of which have been operating fairly extensive systems for a decade or more and are moving toward full digitalisation of their systems, such as Canada and New Zealand, tax agents are not made liable under the law for failures to submit tax returns for or on behalf of their clients. These matters are left to be resolved as contractual issues between taxpayers and the persons that they may engage.

- The proposed section 80K of the IRO introduces a number of penalties which may be applied to an SP. We find these confusing.

The obligation to furnish a return under section 51(1) remains the taxpayers and the definition of SP refers to "a person engaged to carry out a taxpayer's obligation under section 51(1)". It seems confusing, therefore, to introduce an offence, under the proposed section 80K(2), for which an SP may be liable, of failing to comply with an obligation that is fundamentally a taxpayer's obligation. The responsibility of the SP should be a contractual responsibility owed to the taxpayer.

- Section 80K(2) provides that an SP commits an offence if the SP, without reasonable excuse, fails to furnish the return for or on behalf of the taxpayer. At the same time, 80K(3) provides that an SP commits an offence if without reasonable excuse, the SP fails to comply with, inter alia, section 51AAD(3) (which requires that, before the return is furnished to the Commissioner, the SP must obtain a confirmation (in a form specified by the Commissioner) from the taxpayer stating that the information contained in the return is correct and complete to the best of the taxpayer's knowledge and belief). If the SP is unable to obtain the taxpayer's confirmation by the tax filing deadline due to delay on the taxpayer's part, the SP faces a dilemma as to whether to file the return, as the SP is at risk of committing an offence either way. This would appear to impose an undue burden on SPs and, ultimately, discourage professionals from taking up this role.

- Similarly, the proposed section 80K(4) creates an offence where "the service provider furnishes the return for or on behalf of the taxpayer but not in accordance with the information provided, or the instructions given, by the taxpayers and the return so furnished is incorrect in a material particular..." This too would appear to create an offence for a possible breach of a contractual duty owed by the SP to the taxpayer, for which the normal remedy would be a civil claim. It seem unreasonable to prescribe a statutory offence for a situation where, for example, an SP may have made an inadvertent mistake which may not amount even to negligence.

- Under the proposed section 80L, a court may order an SP to, among other things, furnish a return under section 80K(2). Under what circumstance is it envisaged that this provision may be invoked? Again, we are concerned that this confuses responsibilities because the primary responsibility remains with the taxpayer; so, if a return has not been furnished, even where a taxpayer has engaged an SP, surely the taxpayer should be required to furnish it? Any issues that there may be with the SP should be left to be dealt with via the engagement contract.

- There are several provisions in this part of the Bill stating that "engaging a service provider SP (as defined by section 51AAD(8) under section 51(AAD(1) does not itself constitute a reasonable excuse". In our view, this should be a matter for the court to decide in the specific circumstances of the case. Based on the facts and circumstance of the case, engaging an SP may or may not constitute a reasonable excuse, and the possibility that it may constitute a

reasonable excuse should not be ruled out under the law.

- It is also not clear whether the proposed penalties would be applicable only after the enactment of the new provisions, or whether there would be some retrospective effect.

- In view of the above, we would reiterate our strong reservations in relation Part 4 of the Bill in its present form, on the basis that it may create ambiguities and uncertainties, particularly around the question of the respective responsibilities and liabilities of taxpayers and SPs.

- We do not know the rationale for some of the proposals referred to above but if, for example, there were a concern on the part of the Administration that, under an e-filing system, there may be greater scope for returns to be altered online before being submitted to the IRD, one possibility would be to address this through the design architecture of the system. For example, the system could be designed so that the taxpayer is required to e-sign on the return before the SP submits it and, once this has been done, the return cannot be amended without using a new e-return and/ or requiring the taxpayer to re-sign. We understand that, in some jurisdictions, the e-filing system may operates in this way. At the same time, this highlights that, at this stage, little is known about the details of how the e-filing system in Hong Kong will operate, and, therefore, that it is too early to make decisions about the statutory roles, responsibilities and liabilities of the different stakeholders in the system.

- In view of the above, we hope that the Bills Committee will understand the potential uncertainties and difficulties that taxpayers and SPs will face if Part 4 of the Bill is passed in its present form.

Part 5

3. Amendments relating to deduction of foreign tax

- Clarification is needed as to whether the proposed definition of "specified tax" will cover the foreign taxes calculated on a "deemed profit" basis, similar to section 21A of the IRO where "withholding tax on royalties" (as commonly referred to) is calculated based on a deemed profit rate (30% or 100%) multiplied by the applicable profits tax rate.

- We would suggest that there should be interim concessionary measures with respect to foreign taxes paid during the "transition period" (from the issue of the revised IRD Departmental and Interpretation Notes No. 28 to the effective date of these new provisions) in the same manner. We would also suggest that the IRD limits any enforcement action in relation to deduction cases identified during the said period.

We should be happy to answer any questions that the Bills Committee may have on this submission or to provide further information, if required.

Yours sincerely,

Peter Tisman
Director, Advocacy & Practice Development

PMT/pk