Bills Committee on Inland Revenue (Amendment) (No. 6) Bill 2017
Follow-up to the meeting on 13 February 2018

At the meeting on 13 February 2018, the Government was requested to –

(a) clarify the interaction between the proposed transfer pricing ("TP") rules under the Inland Revenue (Amendment) (No. 6) Bill 2017 ("the Bill") and the existing rules for determining the source of income or profit under the territorial-based tax regime of Hong Kong, including which set of rules will prevail in case of conflict; and

(b) provide written response to the views and concerns raised by deputations/individuals at the meeting and/or in their written submissions.

Overall response

2. The deputations in general are supportive of Hong Kong to honour its international tax obligations by implementing the Base Erosion and Profit Shifting ("BEPS") package whilst maintaining the simple and low tax regime. We welcome their support. The Bill is in line with our policy intent to codify the TP rules into our tax law and implement the minimum standards of the BEPS package.

3. The Bill proposes targeted measures to address BEPS-related matters. Meanwhile, the Organisation for Economic Co-operation and Development ("OECD") will conduct comprehensive peer review on all participating jurisdictions, including Hong Kong, to assess their compliance with the anti-BEPS requirements. Hence, it is incumbent for Hong Kong to put in place a legislative framework for these anti-BEPS requirements as soon as practicable. The Government has earmarked additional resources for the Inland Revenue Department ("IRD") in 2017-18 and beyond to ensure the effective implementation of the BEPS package in Hong Kong and oversee the peer review process.

4. Our responses to the key concerns raised by the stakeholders are set out in this paper.

Key Concerns

Interaction between the TP rules and the existing rules for determining the source of income or profit under the territorial-based tax regime of Hong Kong

5. We would like to emphasise that our long-established territorial source principle of taxation will not be changed as a result of the codification of the TP rules. The TP rules require the computation of income or profits from transactions with associated persons on an arm's length basis for tax purposes. After ascertaining the amount of income or profits, IRD will apply the territorial source principle of taxation to determine whether and, if so, the extent to which such income or profits arise in or are derived from Hong Kong. The territorial source principle will continue to determine the chargeability of income or profits to Hong Kong tax. This practice has been set out in paragraph 71 of the existing Departmental Interpretation and Practice Note ("DIPN") No. 46. IRD will provide further clarification on this aspect when updating its DIPN.

Application of the arm's length principle to domestic transactions

6. TP refers to the setting of prices for transactions between associated persons for tax purposes. The arm's length principle is the internationally recognised standard for setting transfer prices. IRD has issued dedicated DIPNs on TP since 2009. It covers the arm's length principle, TP methodologies and the practice adopted by IRD in dealing with TP issues. They are consistent with the TP guidelines promulgated by the OECD.

7. The Bill seeks to **codify IRD's existing practice** in dealing with TP issues. IRD has all along required taxpayers to apply the arm's length principle to transactions between associated persons, **regardless of the size of company** (i.e. multinational enterprises and small and medium enterprises), **type of transactions** (i.e. domestic and cross-border transactions) **and taxes** (i.e. profits tax, salaries tax and property tax). In

practice, IRD will consider the overall Hong Kong tax position of the transactions involved in the application of TP rules.

8. We note that quite a number of deputations query the need for applying the TP rules to domestic transactions amid concerns over the compliance burden on businesses arising from the application of the arm's length principle and preparation of the relevant supporting documents. Some have suggested fully or partially carving out domestic transactions from the scope of the TP rules.

9. We would like to emphasise that the proposed application of the TP rules to both cross-border and domestic transactions is in line with the practice adopted by major jurisdictions overseas, in particular those from OECD/G20 countries and the Member States of the European Union. Such application is also consistent with IRD's prevailing practice. Indeed, domestic transactions conducting on non-arm's length basis may give rise to significant tax leakage. For example, payment of an excessive service fee to a loss-making group company would result in a deferral of tax liabilities.

10. Having regard to stakeholders' concerns and the prevailing practice of IRD, we plan to make it clear in DIPN that TP rules would generally not be applied to **domestic transactions between associated persons which do not give rise to actual tax difference**.

TP documentation requirements

11. We strive to balance the need to meet the international tax standards and to relieve the compliance burden on the business sector as far as practicable. After the consultation exercise conducted in late 2016, we have relaxed the exemption threshold based on the business size of company and introduced new exemption thresholds based on the nature and value of related party transactions in relation to the preparation of master and local files. Enterprises engaging in transactions with associated enterprises will not be required to prepare master and local files if they can meet either one set of the exemption thresholds.

12. Several deputations have called on the Government to exclude domestic transactions from the scope of preparing master and local files so

as to further relieve the compliance burden arising from TP documentation. There are also views that enterprises should be given a **longer period** to prepare the master file and local file, as it would take time for the enterprises to obtain the necessary information from their ultimate parent companies located in other jurisdictions (in the context of master file) and sort out the detailed transactional TP information (in the context of local file).

13. To further relieve the compliance burden for the business sector, we propose to **waive the requirement to prepare master and local files for those domestic transactions between associated persons**. We will also propose to **extend the preparation period from 6 months to 9 months after the end of the accounting period of the enterprises concerned so as to tally with the tax return filing deadline**. We plan to move committee stage amendments ("CSAs") to make the proposed amendments accordingly.

Application of the Authorised OECD Approach for attributing income or loss to permanent establishments of non-Hong Kong resident persons

14. The Authorised OECD Approach ("AOA") as reflected in section 50AAK seeks to attribute income or loss to a permanent establishment ("PE") of a non-resident enterprise in Hong Kong as if the PE is a distinct and separate entity having regard to the functions performed, assets used and risks assumed by the PE. It is an international standard incorporated as part of the Model Tax Convention on Income and on Capital as approved by the OECD.

15. The AOA has also been incorporated in Hong Kong's Comprehensive Avoidance of Double Taxation Agreements ("CDTAs"). Enterprises resident in the relevant CDTA territories have already been required to adopt the AOA for attributing profits to their PEs in Hong Kong. Equally, enterprises resident in Hong Kong are already subject to the same AOA approach in respect of their PEs in the relevant CDTA territories. We consider it appropriate to align the treatment for CDTA and non-CDTA territory residents through the Bill.

16. We understand that some stakeholders, particularly those from the financial services sectors, are concerned about the corresponding changes to

their business operations and financial reporting systems following the implementation of AOA. They would like to have a longer lead time to prepare for the changes and more guidance from IRD to facilitate compliance with the AOA. Having regard to the deputations' suggestion, we propose to **defer the implementation of AOA by 12 months,** i.e. the AOA will apply in relation to a year of assessment beginning on or after 1 April 2019. This will give the relevant taxpayers sufficient time to make necessary preparation. IRD will also promulgate further guidance on the application of AOA. We plan to move a CSA to revise the relevant commencement dates.

Section 15F relating to revenue from intellectual property

17. Section 15F seeks to **align taxation of intellectual property ("IP") income with value creation**. IRD has come across cases where a Hong Kong enterprise is responsible for carrying out the functions of development, enhancement, maintenance, protection or exploitation ("relevant functions") in relation to an IP in Hong Kong but the legal ownership of that IP is taken up by an overseas associated enterprise, which is usually located in a low-tax jurisdiction. While this overseas associated enterprise might not perform any of the relevant functions in relation to that IP, it can earn the subsequent royalty income for that IP but pay a limited amount of tax only in the low-tax jurisdiction. On the other hand, the Hong Kong associated enterprise is **not** remunerated with a reasonable return on its relevant functions and taxed accordingly.

18. The OECD's latest TP guidance requires alignment of taxation with value creation, in particular on IP. Indeed, it is a key objective of the BEPS package to prevent artificial shifting of profits to a low or no-tax jurisdiction where there is little or no economic activity. It is therefore necessary to introduce section 15F into the Inland Revenue Ordinance ("IRO") as a **specific provision** to maintain consistency with the OECD's TP guidance relating to IP. Hong Kong's CDTA partners have also adopted similar approach in their TP work. There should not be any worry that genuine commercial transactions will be affected.

19. Understandably, some stakeholders are concerned about the possibilities of double taxation that may arise[1]. In practice, IRD will make sure that a person will not be subject to double taxation in respect of the same income from an IP. The non-resident associate will also not be chargeable to profits tax in respect of the relevant sum to the extent that section 15F applies. IRD will provide further clarifications in DIPN after the Bill is passed by the Legislative Council.

20. To allow more lead time for taxpayers' preparation, we plan to move a CSA to **defer the commencement of section 15F by 12 months**, i.e. the provision will apply in relation to a year of assessment beginning on or after 1 April 2019.

Double taxation relief

21. Section 50AA proposes that taxpayers can only apply for tax credit under section 50 of the IRO if the double taxation relief involves CDTA territories, while the income exclusion or deduction approach under sections 8(1A)(c) or 16(1)(c) of the IRO will be limited to cases involving non-CDTA territories.

22. Some stakeholders consider that the Bill deprives taxpayers of the option to choose the income exclusion or deduction approach, which is currently available to taxpayers irrespective of whether CDTA territories are involved. There are also views that the proposed section 50AA will deny double taxation relief to an individual who works or an entity which operates in a CDTA territory but is not a resident of either that territory or Hong Kong.

23. A CDTA is intended to provide a comprehensive solution to all tax matters which are within its scope. The international practice is that where a CDTA is in place, relief for foreign tax should be allowed under the CDTA only to the extent contemplated by it. As the tax credit approach is adopted in **all of our existing CDTAs**, it is important for Hong Kong to implement the same approach consistently in the domestic legislation as far as cases

[1] The royalty income received by the overseas associated enterprise for the use of the IP in Hong Kong and the income (if any) received by the Hong Kong enterprise for its performance of relevant functions will also be taxed in Hong Kong.

involving CDTA territories are concerned. This seeks to ensure that the CDTAs would prevail in case of any conflicts between the provisions in the IRO and those in the CDTAs. Indeed, our CDTA partners expect Hong Kong to provide double taxation relief by way of the tax credit approach as agreed under the CDTAs.

24. While a resident of a third jurisdiction is not covered by the CDTA between Hong Kong and the source jurisdiction, the resident may still resort to (a) any unilateral relief available from the resident jurisdiction; or (b) bilateral relief under the CDTA between the resident jurisdiction and the source jurisdiction / Hong Kong.

25. In view of the above, we consider that it will be in the overall interest of Hong Kong for us to adhere to the international practice and keep section 50AA unchanged.

26. Our responses to other technical issues raised by the deputations are in **Annex**.

Way Forward

27. Subject to the views of the Bills Committee, the Government will introduce the relevant CSAs to the Bill.

Financial Services and the Treasury Bureau
Inland Revenue Department
March 2018

Inland Revenue (Amendment) (No. 6) Bill 2017 ("the Bill")

The Government's Responses to Comments / Issues raised by the Deputations

Comments / Issued Raised	Deputations[2]	The Government's Responses
A. TP Regulatory Regime		
A1. TP rules should not apply to Salaries Tax and/or Property Tax	ACCA, AIMA, ASIFMA, AWAHK, CMTC, HKICPA, PwC, TIHK	• It is necessary for Hong Kong to apply TP rules to all tax types in the international context given that many tax jurisdictions operate comprehensive income tax regimes. Also, for some non-arm's length transactions, tax adjustments across tax types are indeed necessary. We therefore consider it **not** justifiable to confine the application of TP rules to profits tax only.
A2. Replace the phrase "<u>the</u> arm's length amount" with "<u>an</u> arm's length amount" (or the appropriate arm's length range) under section 50AAF	ACCA, AIMA, ASIFMA, AWAHK, CMTC, HKAB, HKICPA, HKIFA, JLCT, PwC, TIHK	• The article "the" before "arm's length amount" seeks to clarify that such amount is the one computed on the basis of the arm's length provision of the transaction concerned but not just any transaction. There is no implication that "the arm's length amount" must be one exact figure only. **We would clarify this point as appropriate.**
A3. Change the requirement of "a more reliable measure" to "an equally or more reliable measure" under sections 50AAF, 50AAK and 50AAM	ASIFMA, CMTC, JLCT, PwC, TIHK	• The arm's length pricing acceptable for each case should be determined on its own facts. In general, the application of TP methods may produce a range of figures which are equally reliable to establish the arm's length amount ("arm's length range"). A taxpayer would be accepted as having substantiated his reported/claimed amount if such amount is within the arm's length range. Having regard to the deputations' comments, **we plan to move a committee stage amendment ("CSA") to clarify this point.**
A4. Not appropriate to introduce section 15BA at this stage / Need to clarify the application of section 15BA	ASIFMA, AWAHK, CMTC, Deloitte, HKAB, HKGCC, HKICPA, JLCT, KPMG, PwC, REDA,	• The requirement for adjusting the value of trading stock to market value upon changes other than in the course of trade has been well established by case law and followed in many court judgments. We consider it **necessary** to codify such requirement in the Inland Revenue Ordinance (Cap. 112) ("IRO") by way of section 15BA.

[2] Abbreviations of the deputations are set out in the last page of the **Annex**.

Comments / Issued Raised		Deputations[2]	The Government's Responses
		TIHK	
A5.	Charge a fixed fee (or with a cap) for advance pricing arrangement ("APA") applications	ASIFMA, AWAHK, CMTC, CPA Australia, EY, HKAB, HKICPA, LP, PwC	• In line with the established "user-pay" and "cost recovery" principles of the Government, we consider it **appropriate** to introduce a fee for APA applications following the introduction of the statutory regime. The introduction of this fee is considered necessary as we anticipate that the number of APA applications will progressively increase in future. • We understand that taxpayers would like to have greater certainty over the fees to be charged by IRD for planning purposes. Having regard to deputations' concerns and suggestion, we propose to **impose a cap on the amount of fee to be charged by IRD** in respect of APA applications, excluding the costs of engaging external advisors and travelling expenses as such direct costs will be fully reimbursed by APA applicants. **We plan to move a CSA to the Bill to implement the proposed cap.**
A6.	Replace the phrase "<u>without limiting</u> section 14" to "<u>for the purposes of interpreting</u> section 14" under section 50AAK / Clarify the application of section 50AAK / the interaction between section 50AAK and the territorial source principle of taxation	ASIFMA, AWAHK, CMTC, EY, HKICPA, JLCT, PwC	• Section 50AAK requires the attribution of income or loss to a non-resident's permanent establishment ("PE") in Hong Kong in accordance with the separate enterprise principle for tax purposes. After ascertaining the amount of income or loss, IRD will continue to apply the territorial source principle of taxation to determine whether and if so, to what extent such income or loss arises in or is derived from Hong Kong. IRD will elaborate this point in its DIPN. • We consider that the phrase "without limiting section 14" is appropriate. Section 50AAK(1) is not meant to lay down a hard and fast rule for determining whether a person is carrying on a trade, profession or business in Hong Kong for the purposes of section 14. Depending on the facts and circumstances, a person may still be regarded as carrying on a trade, profession or business in Hong Kong even if it does not have a PE in Hong Kong.
A7.	Clarify the application of the proposed section 50AAK and the existing section 17G of the IRO	HKIFA	• The purpose and application of the proposed section 50AAK and the existing section 17G of the IRO are different. • The proposed section 50AAK seeks to incorporate the separate enterprise principle into the IRO so as to determine the attribution of income or loss to a non-Hong Kong resident person's PE.

Comments / Issued Raised	Deputations[2]	The Government's Responses
		• On the other hand, the existing section 17G of the IRO provides for the basis on which the profits attributable to the Hong Kong branch of a non-resident financial institution ("FI") with capital raised through the issue of regulatory capital securities ("RCS") are to be determined. It is meant to be a specific anti-abuse provision and will be invoked if the Hong Kong branch of a non-resident FI is found to have engaged in a tax avoidance transaction involving the issue of RCS.
A8. Repeal sections 17E, 17F(3) to (6), 17G and/or 20 of the IRO upon the introduction of the fundamental TP rules in the tax law	ASIFMA, CMTC, EY, HKAB, HKGCC, HKICPA, JLCT, KPMG, PwC, TIHK	• We agree with the deputations' comments that section 20 of the IRO is no longer necessary following the introduction of section 50AAF. **We plan to move a CSA to repeal section 20 of the IRO.** • As regards sections 17E and 17F(3) to (6), we consider it **necessary** to retain these sections as the transactions referred therein may not be covered by section 50AAF due to the different meanings of (i) "associate" (defined in section 17A which in turn refers to section 16(3)) and "specified connected person" (defined in section 17F(10) which in turn refers to section 17D(6)) in sections 17E and 17F; and (ii) affected persons as between of which the participation condition is met under section 50AAG, as referred to in section 50AAF(1)(b). • As regards section 17G, the transactions covered by this section may not fall within the ambit of section 50AAK due to the different meanings of "PE in Hong Kong" (referred to in sections 50AAC(4) and 50AAK(2) and Schedule 17G) and "Hong Kong branch" (as defined in section 17G(7)(b)), we consider it **necessary** to retain section 17G.
A9. A fund and its fund manager should not be deemed to have met the "participation condition" notwithstanding the fund's investment or business affairs are managed in accordance with the directions or instructions of the fund manager or the fund manager may hold the "management shares" in the	AIMA, HKAB, HKIFA	• In practice, a fund manager is appointed to implement the investment strategy and manage the portfolio of assets of an investment fund. These activities are carried out in accordance with the terms of a management agreement. In these situations, the fund manager would **not** be regarded as "controlling" the fund and the "participation condition" under section 50AAG would not be regarded as having been met under section 50AAH. • Provided that the "management shares" do not entitle the fund manager to receive dividends, whether in cash or in kind, and a distribution of the

Comments / Issued Raised	Deputations[2]	The Government's Responses
fund.		corporation's assets upon its dissolution (other than a return of capital), they will **not** be taken into account when determining the fund manager's direct or indirect beneficial interest in the fund for the purposes of section 50AAH. • IRD will elaborate its position in DIPN.
A10. Clarify whether share capital includes all classes of shares or just common shares under section 50AAH (if multiple share classes are to be taken into account, the percentage in share capital may not be aligned with the value of the shares issued and hence the result could be distorted)	ASIFMA, CMTC	• In determining whether a person (Person A) "controls" another person (Person B), section 50AAH requires the consideration of, among others, the extent to which Person A has beneficial interest in Person B. Where Person B is a corporation, the extent of beneficial interest refers to the percentage of the issued share capital of Person B held by Person A. In determining such percentage, all classes of shares (not just common shares) issued by Person B should be taken into account. The value of the relevant shares is irrelevant.
A11. Allow certain services to be priced on a cost-basis or with a fixed mark-up, similar to the practices stated in paragraphs 90 to 109 of DIPN 46	ASIFMA, CMTC, HKAB, JLCT	• IRD will take this into account when revising the DIPN on TP.
A12. Clarify whether the domestic TP rules would prevail over the guidelines promulgated by the Organisation for Economic Cooperation and Development ("OECD") in case of difference	ASIFMA, CMTC, HKAB	• As section 50AAE provides that the relevant sections of the Bill should be read in the way that best secures consistency with the OECD rules, we envisage that the statutory TP rules would operate in a manner that is consistent with the OECD rules.
A13. Clarify the application of section 50AAH having regard to the potential impact on the funds and trusts / Reduce the number of definitions for "control" and "associates" in the IRO / The definition of "control" is too broad	AIMA, HKAB, HKIFA, JLCT, KPMG, LP, PwC	• The definition of "control" is derived from the existing provisions of the IRO, i.e. section 16(3A) and Schedules 15 and 15A. To address all possible scenarios, we consider it **necessary** to adopt a sufficiently broad definition of "control". Meanwhile, it is **neither appropriate nor feasible** to provide for a single definition of "control" and "associate" for different purposes of the IRO.

Comments / Issued Raised	Deputations[2]	The Government's Responses
A14. Clarify whether the profits tax exemption under sections 20AC, 20ACA and 26A of the IRO would override section50AAK	AIMA, HKIFA	• Notwithstanding the introduction of section 50AAK, the exemptions provided for under existing sections 20AC, 20ACA and 26A will be available if the conditions prescribed thereunder are met.
A15. Empower the Commissioner of Inland Revenue ("the Commissioner") with the discretion not to apply sections 50AAF and 50AAK under specified circumstances	ASIFMA, CMTC, PwC, REDA	• As consistent implementation of international TP principles is one of the factors that OECD and European Union will take into account when determining whether a jurisdiction's tax practice is potentially harmful, we consider it **inappropriate** to give the Commissioner discretion not to apply the proposed TP rules.
A16. Empower the Financial Secretary to introduce regulations from time to time to specify what types of domestic transactions should be brought within the TP regime	JLCT	• To maintain the overall effectiveness of the TP rules, we consider that the scope of application should cover **all** related party transactions which confer an overall tax advantage on the parties concerned. We consider it **not** justifiable to confine the application of TP rules to certain types of domestic transactions.
A17. Change the term "persons" to "enterprises" for section 50AAF to ensure consistency with the wording in Comprehensive Avoidance of Double Taxation Agreement ("CDTA") and OECD's guidelines	ASIFMA, CMTC	• Since the proposed TP rules will be applicable to salaries tax and property tax, as explained in A1 above which are chargeable on persons not carrying on a trade, profession or business, it is **inappropriate** to change the term "persons" to "enterprises" for section 50AAF.
A18. Provide greater clarity for the interpretation of "transaction" under section 50AAI	KPMG	• The proposed definition of "transaction" is modelled on the definition of the same term under the existing section 61A of the IRO.
A19. Clarify the meaning of "reasonable efforts" under section 82A(1G)	ASIFMA, CMTC, HKAB, JLCT, PwC	• IRD will provide detailed guidance in DIPN.
A20. A revision to APA as a result of an agreement reached under the mutual agreement procedure ("MAP") is open for retrospective application	ASIFMA, CMTC	• In general, a revision to APA as a result of a MAP agreement will not be applied retrospectively.

Comments / Issued Raised	Deputations[2]	The Government's Responses
A21. Clarify in DIPN whether an APA concluded can be rolled back when certain conditions are met	HKAB	• Section 50AAQ(4) empowers the Commissioner to apply the principles developed in an APA to prior years.
A22. Specify details of the APA regime (e.g. grounds for the Commissioner to refuse making an APA and timeline for making an APA application) in the legislation or DIPNs	EY	• IRD will set out details of the APA regime in DIPN.
B. TP Documentation and Country-by-Country ("CbC") Reporting		
B1. Inappropriate to extend the penalty provisions in relation to CbC reporting to cover directors of the reporting entity / The service providers should not be subject to imprisonment for committing an offence in relation to CbC reporting	AWAHK, Deloitte, HKAB, LP, PwC, TIHK	• It is necessary to introduce penalty provisions in the Bill to ensure that the directors of the reporting entity and the service providers engaged by the reporting entity comply with the relevant requirements of CbC reporting. It is worth noting that the proposed penalty seeks to address the cases where the relevant requirements are not compiled with **without reasonable excuses** or **with a willful intent to evade tax** and, in the case of penalty proposed to be imposed on a director, the offence was committed with the consent or connivance of a director. The proposed penalty is in line with the one in relation to the automatic exchange of financial account information under the IRO as approved by the Legislative Council in June 2016 (see the existing sections 80D and 80E of the IRO).
B2. The proposed penalty in relation to CbC reporting is excessive / disproportionate to the offence involved	ASIFMA, CMTC, EY	• As Hong Kong needs to exchange CbC reports with other jurisdictions, it is necessary to impose an appropriate level of penalty to ensure accuracy of such reports.
B3. Allow a roll-forward approach in the context of master file and/or local file so long as there are no substantial changes to the business during the accounting period	ASIFMA, CMTC, HKAB, JLCT	• IRD will consider this suggestion when preparing detailed guidance on TP documentation.

Comments / Issued Raised	Deputations[2]	The Government's Responses
B4. Not necessary to specify in the law the fixed order of presentation and terminology in relation to the master file and local file	ASIFMA, AWAHK, CMTC, JLCT, PwC, TIHK	• The proposed order of presentation and terminology in relation to the master file are in line with the requirements laid down by OECD. However, flexibility will be accorded to taxpayers in complying with the requirements provided that the quality of information therein will not be compromised. Further guidance will be provided in DIPN.
C. Dispute Resolution Mechanism		
C1. Unreasonable to ask taxpayers to bear costs and expenses incurred by the Commissioner for a case submitted to MAP / There should be a cap on the costs and expenses to be imposed by IRD.	ACCA, ASIFMA, AWAHK, CMTC	• We consider it **appropriate** for the taxpayers who initiate the MAP or arbitration cases to bear the relevant cost because it would be in line with the "cost recovery" principles. IRD will provide further guidance on this in the new DIPN. • Taxpayers would only be required to pay or reimburse costs and reasonable expenses incurred in relation to MAP and arbitration cases, such as costs of travelling and arbitrators. It would be reasonable not to impose a cap on such costs and expenses as they could vary from case to case and are indeed beyond the control of IRD.
D. Double Taxation Relief		
D1. Clarify whether the "double taxation arrangements" also cover air services income or shipping income agreements	JLCT, KPMG	• The term "double taxation agreement" in the Bill should generally **not** cover the air services income and shipping income agreements. We plan to introduce a **CSA** to the Bill to clarify this point.
D2. Explain how the introduction of section 49(1C) of the Bill would enhance the current provisions of the IRO in relation to double taxation relief under the CDTAs	ASIFMA, CMTC, EY, HKAB	• Section 49(1C) seeks to ensure that CDTA provisions would always prevail with respect to certain matters, including affording relief from tax charged under the IRO. The proposed provisions are in line with the international standards for CDTAs.
D3. Amend section 50AAN(2) so as to provide corresponding relief to cases where no MAP is concluded so as to minimise the burden and cost on the taxpayers	ASIFMA, CMTC, KPMG	• Section 50AAN seeks to provide corresponding relief in respect of a TP adjustment imposed by a **CDTA territory**. It is appropriate to resolve such issue through MAP because if the issue cannot be resolved unilaterally by Hong Kong, the competent authorities of Hong Kong and the DTA territory will have to consult each other with a view to reaching a mutual agreement.

Comments / Issued Raised	Deputations[2]	The Government's Responses
		• However, for simple cases, the competent authority of Hong Kong will seek to grant the corresponding relief unilaterally without resorting to MAP. We anticipate that the burden and cost on taxpayers would not be significant.
D4. Remove the requirement for taxpayers to take all foreign tax minimisation steps in obtaining double taxation relief / provide clarification on the application of section 50AA	HKAB, JLCT, KPMG	• We have to clarify that taxpayers are only required to take all reasonable steps to claim the normal relief and allowances available to all entities under the tax regimes of the territory concerned, having regard to the costs and benefits of taking those steps. This requirement does not imply that foreign tax planning is needed. For clarity sake, IRD will provide further guidance in DIPN.
D5. Amend section 50(5) of the IRO to make the legislative intent clearer	KPMG	• Further guidance on tax credit (with illustrative examples) will be provided by way of DIPN after the enactment of the proposed amendments to section 50.
E. Amendments to Preferential Tax Regimes		
E1. The ring-fencing effect will remain as the proposed amendments limit the amount of tax deduction to be granted to the associated enterprises	EY, TIHK	• Section 16(1A) seeks to prevent tax arbitrage through transactions between connected persons. It is not meant to ring fence any preferential tax regime. We consider that the proposed amendments to the relevant tax regimes will be able to meet the OECD's requirements.
E2. Consult the stakeholders on the threshold requirements for determining whether the profits producing activities are carried out in Hong Kong and provide clear guidance before implementation	ASIFMA, CMTC, HKAB	• The Government will consult the stakeholders concerned on the threshold requirements.

Abbreviations of the Deputations

ACCA	Association of Chartered Certified Accountants Hong Kong
AIMA	The Alternative Investment Management Association Limited
ASIFMA	Asia Securities Industry & Financial Markets Association
AWAHK	Association of Women Accountants (Hong Kong) Limited
CMTC	Capital Markets Tax Committee of Asia
CPA Australia	Certified Practising Accountants Australia Limited
Deloitte	Deloitte Advisory (Hong Kong) Limited
EY	Ernst & Young Tax Services Limited
HKAB	The Hong Kong Association of Banks
HKGCC	Hong Kong General Chamber of Commerce
HKICPA	Hong Kong Institute of Certified Public Accountants
HKIFA	Hong Kong Investment Funds Association
JLCT	Joint Liaison Committee on Taxation
KPMG	KPMG Tax Limited
LP	Liberal Party
PwC	PricewaterhouseCoopers Limited
REDA	The Real Estate Developers Association of Hong Kong
TIHK	The Taxation Institute of Hong Kong