

Bills Committee on Inland Revenue (Amendment) (No. 7) Bill 2017

**Response to Submission from
the Hong Kong Institute of Certified Public Accountants**

Purpose

Further to our written response on 5 February 2018 to four submissions received by the Bills Committee, this note sets out the Government's response to the submission from the Hong Kong Institute of Certified Public Accountants ("HKICPA") received by the Bills Committee on 6 February 2018.

Policy Approach

2. We are pleased to note that HKICPA supports the proposed two-tiered profits tax rates regime as the initiative will help small and medium enterprises ("SMEs") and start-up companies. We thank for its support in this regard.

Definition of connected entities

3. HKICPA remarked that the proposed definition of "connected entities" seems to be less rigorous than the definition of "associate" in other parts of the Inland Revenue Ordinance ("IRO").

4. We would like to point out that there must be a clear dividing line for defining which entities are connected. To this end, we propose to adopt 50% as the dividing line. An entity would have control over the other if it controls more than 50% of the other's interest or profits. Thus, a clear boundary can be drawn for each group of connected entities. The majority shareholder or partner who has the dominant control of his connected entities can determine which of them can elect the two-tiered rates. As the threshold is clear and objective, disputes among shareholders or partners would be minimised.

Nomination of connected entities

5. HKICPA enquired whether there is scope to adopt a more straightforward drafting approach for the proposed section 14AAC on charge of profits tax for connected entities.

6. From a policy perspective, it may be reasonable to take the straightforward view that, under the IRO as amended by the Inland Revenue (Amendment) (No. 7) Bill 2017 (“the Bill”), an enterprise will not enjoy the two-tiered profits tax treatment if two conditions are met, namely, (a) that the enterprise is connected to another entity; and (b) that the enterprise has not elected the two-tiered profits tax treatment. However, from a legislative drafting perspective, one must note the fact that under the amended section 14 of the IRO, the starting position is that an enterprise will enjoy the two-tiered profits tax treatment. It would be conceptually problematic to refer to the “election of two-tiered profits tax rates” at the outset of the proposed section 14AAC of the IRO. It is therefore necessary to first provide that, for a connected enterprise, section 14 of the IRO is to disapply to a certain extent. In this regard, it should be noted that the tax rate is only one of the aspects that section 14 of the IRO covers. That section also provides for the basic principle that profits tax is to be charged in respect of a person’s assessable profits arising in or derived from Hong Kong from the trade, profession or business carried on by that person, which continues to apply to an enterprise even if it is connected to another entity. In other words, in so far as the connected enterprise is concerned, section 14 of the IRO is to apply except only for the two-tiered rates of profits tax treatment. To accurately reflect that policy intent, the proposed section 14AAC(3) of the IRO provides for the modifications of section 14 of the IRO for a connected enterprise. Accordingly, the election of two-tiered profits tax treatment by a connected enterprise is treated as an exemption in the ensuing provision (i.e. proposed section 14AAC(4)). The current drafting approach thus ensures that the level of precision and logical clarity required for legislation is achieved.

Tax treatment of income from qualifying debt instruments

7. HKICPA enquired how the interest, gains or profits derived from qualifying debt instruments (“QDI”) would be excluded from the two-tiered profits tax rates regime under the Bill.

8. An enterprise could have assessable profits from QDI and other sources. Section 14A of the IRO provides that interest, gains or profits derived from QDI are chargeable to profits tax at one-half of the rate specified in Schedule 1 (15%) or Schedule 8 (16.5%), as the case may be. The present Bill has not amended the existing section 14A of the IRO. Thus, such interest, gains or profits would continue to be taxed at 7.5% or 8.25% after the implementation of the two-tiered profits tax rates regime. Assessable profits from businesses unrelating to QDI would be chargeable to profits tax at the two-tiered rates under the proposed section 14(2), (3) or (4) of the IRO. With the above, profits relating to QDI would not be counted towards the “cap” of \$2 million of assessable profits under the proposed Schedule 8A or 8B of the IRO.

9. We agree that the Bill may be fine-tuned to reflect the above policy intent more clearly. Therefore, we have proposed CSAs to change the references to “assessable profits” in the proposed Schedules 8A and 8B to assessable profits to which section 14 of the IRO applies.

**Financial Services and the Treasury Bureau
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