



Hong Kong Tax Newsflash

Passage of bills on tax treatment on amalgamation; deductions of foreign tax; filing of returns; and increased stamp duty rate on stock transfers



Hong Kong's Legislative Council passed the *Inland Revenue (Amendment) (Miscellaneous Provisions) Bill 2021* and the *Revenue (Stamp Duty) Bill 2021* on 2 June 2021. The bills cover:

- tax treatment on amalgamation;
- deductions of foreign tax;
- filing of tax returns; and
- increase in stamp duty rate on stock transfers.

Bills committees were formed to scrutinize the bills before their passage. Despite various stakeholders submitting their views, both bills were passed without amendments. Please refer to our [Hong Kong Tax Newsflash \(Issue 138\)](#) and [Hong Kong Tax Newsflash \(Issue 137\)](#) for the key features of the bills.

This Tax Newsflash highlights discussions in bills committee meetings, during which the government clarified various issues. These are instructive for taxpayers to understand the government's legislative intent and Inland Revenue Department's (IRD) implementation practices.

[Tax treatment of court-free amalgamations of companies](#)

The Bill introduced a set of special tax treatments for qualifying amalgamations upon election. Please click this table for accessing the summary of special tax treatments. For the detailed tax treatments and technical analysis, please refer to our [Hong Kong Tax Analysis \(Issue H103/2021\)](#).

	Outgoing tax	Incoming tax
Application of special tax treatments (upon election)	Yes	Yes
Discretion to elect from assessable profits to set-off against tax	Special rules on carry-over of tax of amalgamated company to target or acquirer	Treatment of special rules on carry-over of tax of amalgamated company
Indemnity	Special rules on carry-over of tax of amalgamated company to target or acquirer	Treatment of special rules on carry-over of tax of amalgamated company
• Used in setting off pre-amalgamation loss against assessable profits of the amalgamated company	Special rules on carry-over of tax of amalgamated company to target or acquirer	Treatment of the loss per account
• Used in setting off pre-amalgamation loss against assessable profits of the amalgamated company	Special rules on carry-over of tax of amalgamated company to target or acquirer	Treatment of the loss per account
• Not used in setting off pre-amalgamation loss against assessable profits of the amalgamated company	Special rules on carry-over of tax of amalgamated company to target or acquirer	Treatment of special rules on carry-over of tax of amalgamated company
Set-off against assessable profits of the amalgamated company	Special rules on carry-over of tax of amalgamated company to target or acquirer	Set-off against assessable profits of the amalgamated company
Set-off against assessable profits of the amalgamated company	Special rules on carry-over of tax of amalgamated company to target or acquirer	Set-off against assessable profits of the amalgamated company
Set-off against assessable profits of the amalgamated company	Special rules on carry-over of tax of amalgamated company to target or acquirer	Set-off against assessable profits of the amalgamated company

The Bills Committee on the *Inland Revenue (Amendment) (Miscellaneous Provisions) Bill 2021* deliberated on conditions for setting-off pre-amalgamation losses. There were views that some of the conditions are unduly restrictive and could limit commercial practice. Nevertheless, all of the conditions were retained in the Bill. The government elaborated on the following conditions:

- The "good commercial reasons" condition

In determining whether there are "good commercial reasons" for carrying out a qualifying amalgamation, the IRD will consider all relevant facts and circumstances specific to each case, such as the reasons and circumstances of the amalgamation, what result it is intended to achieve or has achieved, the non-tax purpose of the amalgamation, and whether there are alternative ways of achieving the non-tax purpose. If a tax benefit is only an incidental consequence of the qualifying amalgamation, obtaining this tax benefit will not be considered a main purpose and, subject to the satisfaction of other conditions, the pre-amalgamation loss will be allowed to be set-off.

- The "same trade" condition

This condition establishes that a pre-amalgamation loss of an amalgamated company can only be used to set off against the assessable profits of the amalgamated company derived from the same trade succeeded. For example, a company operating a Japanese restaurant is making a loss before amalgamation. To improve synergy, it amalgamates with another group company carrying on a catering business. If, for commercial reasons, the amalgamated company's business is converted into operating an Italian restaurant, under the IRD's current practice, this would not be considered as carrying on the "same business", and the pre-amalgamation tax loss is unlikely to be able to be utilized after amalgamation. There is the view that this condition is unduly restrictive and could hinder commercial practicality.

The government re-iterated that the intent of the "same trade" condition is to prevent the transfer of losses between group companies through amalgamation. Singapore applies the "same trade" condition in similar situations. This condition was therefore retained.

Meanwhile, the Secretary for Financial Services and the Treasury, Mr. Christopher Hui explained in his speech at the Legislative Council meeting that the IRD will consider all the relevant facts and circumstances, such as the business model, operational style, brand, etc. in determining whether the "same trade" condition is satisfied. We welcome this comment and look forward to the IRD taking a more flexible approach in instances where the main purpose of the amalgamation is not to obtain a tax benefit by transferring a loss between group companies.

- The "financial resources" condition

This condition requires that the amalgamated company must have adequate financial resources (excluding intra-group loans) to purchase the business of the amalgamating company. The government explained that the "financial resources" condition is intended to minimize the risk of achieving group tax loss relief through amalgamation. If the condition is removed or relaxed, an amalgamated company might make use of its losses to set off the profit of an amalgamating company to avoid tax, even if the amalgamated company has no financial ability to carry on business. This condition was therefore retained.

In applying the financial resources condition, the IRD will consider whether, on the date of amalgamation, the amalgamated company has sufficient capital, liquid assets or cash to carry on business, and its ability to raise funds from independent third parties having regard to its own credit rating status.

This mechanism for amalgamation will come into operation on the ordinance gazettal date i.e. 11 June 2021. The IRD will provide more guidance by issuing the relevant Departmental Interpretation and Practice Notes with various examples later on.

Foreign tax deduction regime

The Bill provides a deduction for "specified tax", which is defined as a tax charged by a territory outside Hong Kong on a certain percentage of income without deduction for outgoings and expenses when computing the amount of tax. The IRD clarified that foreign taxes on deemed profit will, subject to other conditions, be deductible if they are charged based on turnover.

For details of the foreign tax deduction regime, please refer to our [Hong Kong Tax Analysis \(Issue H102/2021\)](#).

The amendments relating to foreign tax deduction will apply starting from the year of assessment 2021/22.

Statutory framework for the furnishing of tax returns

In addition to providing a statutory framework for the filing of tax returns electronically, the Bill allows taxpayers to engage service providers to furnish tax returns for or on their behalf, irrespective of the mode in which a return is furnished (i.e. paper, electronic or a mix of the two). The service provider is required to obtain a written confirmation from the taxpayer stating that the information contained in the return is correct and complete, and retain this for not less than seven years.

Although the Bill contains specific provisions which clarify that the engagement of a service provider to furnish a tax return will not relieve the taxpayer from their related obligation, it also sets out penal provisions against service providers for certain acts without reasonable excuse, including failure to furnish returns, failure to obtain a written confirmation from the taxpayer, and furnishing incorrect tax returns.

This mechanism will come into operation on the ordinance gazettal date i.e. 11 June 2021.

Clarification on the role and liability of a service provider

Under section 51AAD(8) of the Bill, "service provider" means a person engaged to carry out a taxpayer's obligation to furnish returns under section 51(1). The government clarified that this is intended to refer only to a person who furnishes the tax return on behalf of the taxpayer (i.e. the one signing the return) irrespective of the way in which a return is furnished (i.e. paper, electronic or a mix of the two). In other words, a person engaged by a taxpayer to undertake only preparatory work such as preparing profits tax computations and other supporting documents, filling in the return form, etc. is not a service provider for the purposes of the penal provisions unless it also furnishes the tax return on behalf of the taxpayer.

Plan on mandatory e-filing of tax returns

In the Bills Committee meetings, the IRD revealed its plan to enable more businesses to voluntarily e-file profits tax returns and financial statements in 2023, with the ultimate goal of implementing e-filing of profits tax returns through the newly developed Business Tax Portal in 2025. The IRD's preliminary thinking is to first require large businesses (e.g. with turnover above a certain threshold) or businesses in certain sectors (e.g. financial institutions) to make their filings electronically. This might later be extended to cover other classes of businesses or entities. The government might also consider allowing micro enterprises (e.g. with turnover below a certain threshold) to continue filing profits tax returns in paper form. Before the implementation of mandatory e-filing, the IRD will duly gauge views from stakeholders in preparation for the subsidiary legislation, which is subject to negative vetting by Legislative Council.

Increase in stamp duty rate for stock transfers

The *Revenue (Stamp Duty) Bill 2021* gives effect to the proposal made in the 2021-22 Budget to increase the rate of stamp duty payable on contract notes for stock transfers from 0.1% to 0.13% for the buyer and seller, with effect from 1 August 2021. The objective of this policy is to increase government revenue to address its fiscal needs in the short-to-medium term while striking a balance between increasing government revenue and sustaining financial market development.

The technical details of some of the above mechanisms, especially tax treatment on amalgamation, are complex. Taxpayers should seek professional advice before seeking to apply the relevant tax treatments.

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