



KPMG & TEI Asia Chapter Seminar: How does Hong Kong react to changes of international tax laws?

Wednesday 31 July 2019





KPMG & TEI Asia Chapter Seminar: How does Hong Kong react to changes of international tax laws?

Please scan the QR code to view the agenda,
speaker biographies, presentation slides and
KPMG Insights on your mobile device.



***Tax Executives Institute
An Overview
2019***



TAX EXECUTIVES INSTITUTE, INC.

About the TEI

The TEI is the preeminent association of in-house tax professionals worldwide. Today, the TEI has nearly 7,000 members, aligned in 57 separate chapters, and representing over 2,800 leading businesses in the United States, Canada, Europe, and Asia. In 1999, TEI formed its EMEA Chapter; the Asia Chapter was established in 2005; and a charter was approved in 2014 for the Latin America Chapter.

The mission of the TEI is to enhance and improve the tax system and to serve its members, their employers, and society generally by facilitating interaction among, and the training of, members and their staff, by effectively advocating its members' views, and by promoting competence and professionalism in both the private and government sectors.

Please visit http://www.tei.org/organization/Pages/about_tei.aspx to learn more.



TAX EXECUTIVES INSTITUTE, INC.

What Makes TEI Unique?

- Broad-based membership—TEI is not affiliated with any other industry group or association
- Experienced—founded over 70 years ago
- Flexible and informed of local interests—chapters plan meetings and other activities taking into account their unique circumstances
- Privacy—confidentiality allows members to be candid and discuss difficult issues freely
 - Chapter meetings are generally closed to consultants, vendors, and the media
 - TEI Conference sessions are also closed, EXCEPT where a government official is speaking



Three Core Areas of Activity

- Networking
 - Access to worldwide, in-house tax professionals network of nearly 7,000 members via face-to-face meetings, one-on-one correspondences, web-based members only forums
- Education
 - Affordable, best-in-class training which are member-focused and provide perspectives of in-house practitioners, industry and governmental officials as well
- Advocacy
 - Broad-based member-driven advocacy that crosses industry lines. Thus, governments are comfortable that we are advocating for change that will benefit taxpayers generally, as opposed to a particular special interest group.



TEI's Growing Presence in Asia Pacific

- Individual members employed across a range of companies (including a significant number of Fortune 100 and Fortune 500 companies) in a wide variety of industries
- Members mainly spread across Australia, China, Hong Kong, India, Korea and Singapore. Efforts underway to continue to raise TEI's profile in these countries and also the rest of Asia Pacific
- "Access Granted" initiatives



TEI Asia Operational Structure and Purpose

- Led by President, TEI Asia. Board members currently situated across China, Hong Kong, India, Korea and Singapore
- Currently, there are VP roles (for each of China, Hong Kong, India, Korea and Singapore) created to ensure dedicated focus on TEI's core pillars of networking, education and advocacy
- Transfer Pricing and Indirect Tax sub-committees started in 2016; Membership sub-committee started in 2017
- Initiated the TEI Fellows programme since 2016 and inducted Fellows based in China, Hong Kong, India and Singapore in the past two batches of Fellows



Highlights of 2018 events

- TEI-EDB and TEI-IRAS dialogues
- TEI-Dhruva India and Singapore budget update
- US tax reform update
- TEI-Baker & McKenzie seminars in Hong Kong and Singapore
- Lunch & Share sessions in Singapore and Shanghai
- TEI-PwC China tax conference
- TEI-KPMG tax accounting class – China
- Indirect tax and transfer pricing update sessions
- TEI-EY Transfer Pricing Advanced Class (SG, HK, SH)



Highlights of 2019 events

- TEI-EDB and TEI-IRAS dialogues
- TEI-Dhruva India and Singapore budget update
- US tax reform update
- IRD Transfer Pricing seminar
- TEI-Baker & McKenzie seminars in Hong Kong and Singapore
- Lunch & Share sessions in Singapore and Shanghai
- TEI-PwC China tax conference
- TEI-KPMG tax accounting class – China
- TEI-EY Transfer Pricing Advanced Class (HK- Oct 2019)
- Minter Ellison - TEI on Australia Tax update (to be held in Singapore in Oct 19)
- TEI – WTS Senior Tax Leadership workshop to be held in Singapore in March 2020
- Career and soft skills training



Becoming a TEI member

To be eligible for membership, applicants must:

- Agree to abide by TEI's professional standards.
- Have a minimum of five years of corporate tax experience or its equivalent.
- Please visit http://www.tei.org/organization/Pages/about_tei.aspx to learn more and to register to become a member.
- Fees : ~~One-time initiation fee of USD 225*~~; Annual membership fee of USD 275

Membership is not open to public tax practitioners or other consultants. If you have further questions about membership, please visit www.tei.org or contact Du Nan, our TEI Hong Kong at tchuk@Trinseo.com

* Initiation fee waiver available until 30 June 2019 under the "Access Granted" programme



TAX EXECUTIVES INSTITUTE, INC.

Thank you



TAX EXECUTIVES INSTITUTE, INC.



Offshore Economic Substance Laws - What you need to know

Eugene Yeung
31 July 2019



Key points



01

Key framework



02

Carve-outs



03

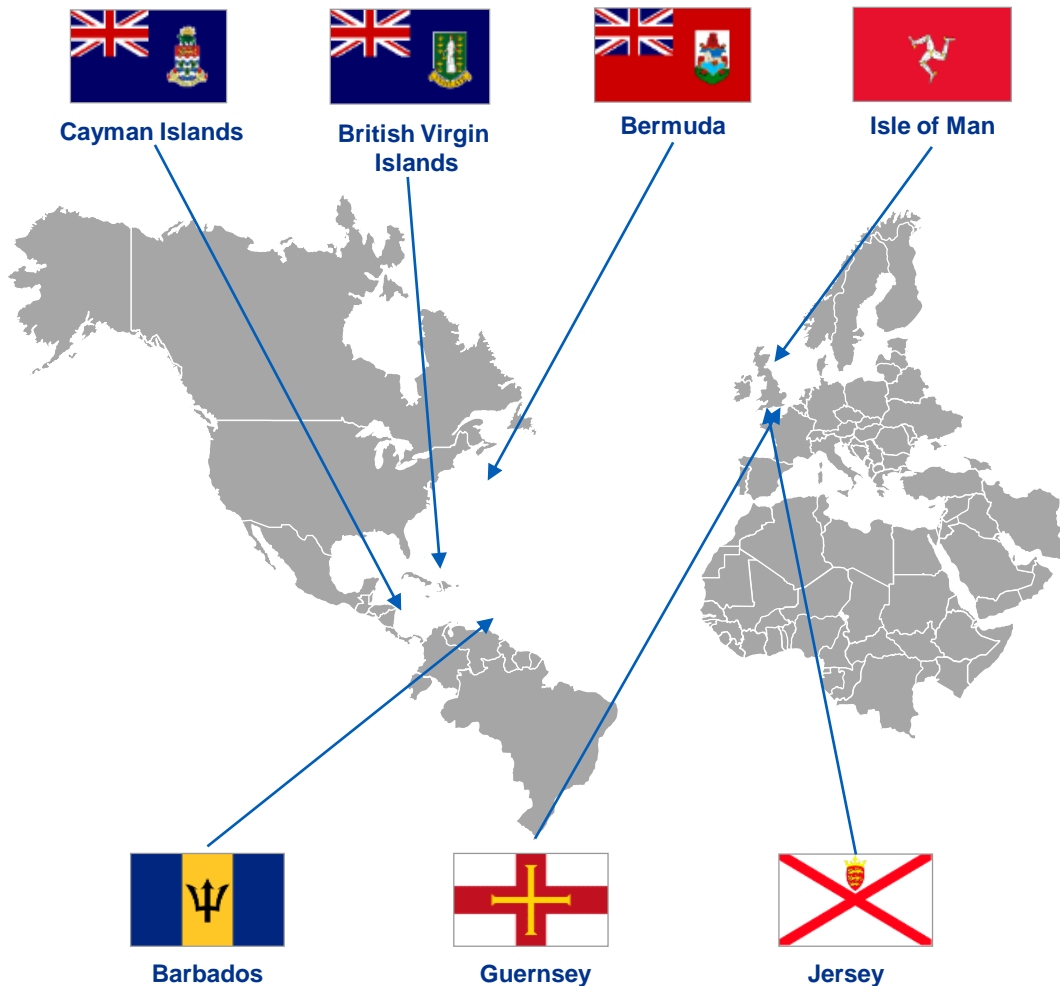
Harsh penalties for
non-compliance



04

Next steps










Economic Substance Laws - Overview








- A response to pressure from EU and OECD on enhancing global tax transparency and combatting harmful tax practices
- Companies that fall within the law will be required to maintain substance in the offshore jurisdiction to align operational substance with where profits are booked
- Laws are effective from 1 January 2019
- Under the framework, Relevant Entities carrying out Relevant Activities should fulfil the Economic Substance requirements subject to certain carve-outs
- Annual reporting
- Harsh penalties for non-compliance

Framework

9 Relevant Activities:

-  Holding company
-  Banking business
-  Distribution and service center
-  Finance and leasing
-  Fund management
-  Headquarter business
-  Insurance business
-  Intellectual property (IP) holding
-  Shipping business

Economic Substance:

-  Physical premises
-  Adequate employees
-  Managed and directed (Board)
-  Core Income Generating Activities (CIGA)
conducted locally
-  Operating expenditure

Key activities to focus on



Holding companies

- Passive equity holding companies earning dividends and capital gains
- Excludes active investment trading

Substance / CIGA

- Limited substance required for pure investment holding companies
- Registered office only?
- For others:
 - Office premises and suitably qualified employees
 - Local directors and physical directors meetings
 - If outsourced / shared employees, managed as if they are the entities' own employees



Financing business

- Intra-group company lending
- Shareholder loans
- Other financing business

Substance / CIGA

- Negotiating or agreeing funding terms
- Monitoring the financing and revising any terms
- Managing any risks
- Approval by directors and physical director meetings

Key activities to focus on



IP companies

- IP such as copyright, patents, trademarks, brand and technical known-how, etc.
- Income includes royalties, capital gains, franchise fees, licensing fees
- High-risk IP legal entity: acquired from and licensed to foreign affiliates
- Presumption of non-compliance (i.e., not conducting CIGA)

Substance / CIGA

- Key employees in BVI / Cayman
- Presumption may be rebutted where the CIGA being carried on in country
- Taking strategic decisions and managing the risks associated with the development and the exploitation of the IP
- Carrying on trading activities through exploitation of the IP



Headquarter business

- Provision of senior management
- Assumption or control of material risk for activities
- Provision of substantive advice in connection with the assumption or control of risk

Substance / CIGA

- Taking relevant management decisions
- Incurring expenditure on behalf of affiliates
- Coordinating group activities
- Local directors



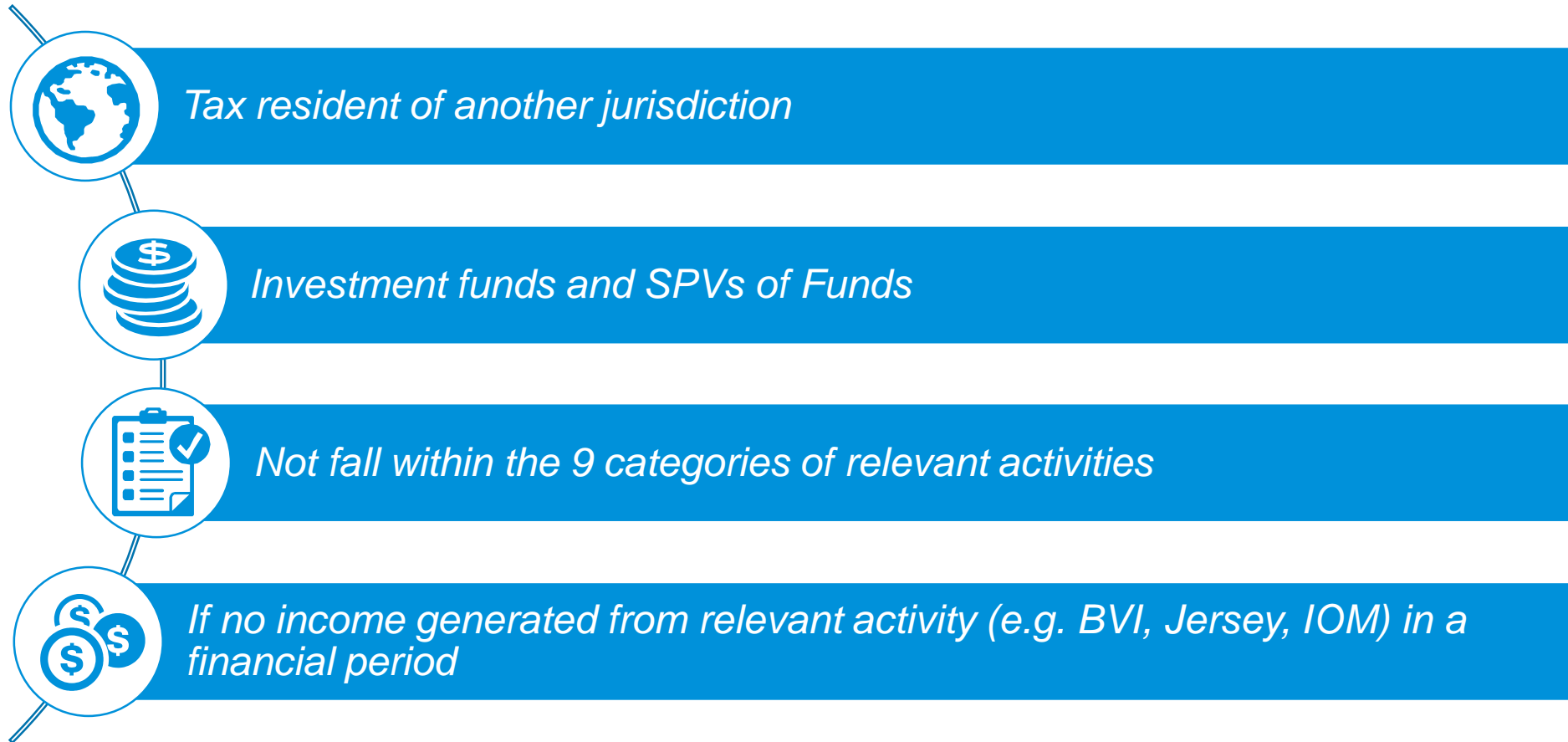
Fund management

- Provide management services to funds
- Investment fund is exempt

Substance / CIGA

- Making decisions on the acquisition and selling of investments
- Majority of these decision making may need to be in BVI / Cayman

Carve outs



Enforcement and penalties



Annual reporting requirements

Annual declaration / reporting required starting from 2020

Registered Agents to report relevant information, including:

- Tax resident in other jurisdictions
- Turnover
- No of employees
- Amount of expenditure
- Business Address
- Basis of rebutting the IP company presumptions
- Details of outsourcing vendors, etc.

Non-compliance

Cayman:

- First year: USD12K per entity
- Subsequent years: fine of USD120K per entity

BVI:

- Non-compliance:
 - from USD5K to USD50K (first determination)
 - from USD10K to USD400K (second determination)
- Non-provision of information/ false reporting (relevant entity/ registered agent):
 - from USD20K to USD250K

Potential imprisonment of a term up to 5 years

Companies can be struck-off after second determination



Harsh penalties

Next steps / Key takeaways

Don't ignore, but don't make hasty or drastic changes!



Review current structure to determine if there are any offshore entities that fall within the scope of ES Laws



Ensure you can comply – build up substance and comply with annual reporting requirements



Alternatively, look at composition of the board and location of meetings



Report as a tax resident in another jurisdiction – consider legal formalities, any potential penalties and historical tax exposures



Monitor the updated guidance especially regarding holding companies



Claims for Tax Benefits under the Mainland-Hong Kong DTA In Accordance with SAT Circular [2018] No. 9

Presented by Sandy Fung / Anthony Pak

July 31, 2019



Agenda

- **Application forms for Certificate of Resident Status (CoR)**
- **Conditions for the application of CoR: Substance requirements**
- **Highlights of the SAT Circular [2018] No.9**
 - **Rules for tax benefits claim on dividends**
- **Information to be provided with CoR application**



Certificate of Resident Status (CoR)



CoR (1/3)

- **A CoR is a document issued by the IRD to a Hong Kong resident who requires proof of resident status for the purposes of claiming tax benefits under the DTA**
- **Application forms: Mainland-Hong Kong DTA (www.ird.gov.hk/eng/tax/dta_cor.htm)**
 - IR1313A (03/2018) for Company, Partnership, Trust or Body of Persons)
 - IR1314A (03/2018) for Individuals

CoR (2/3)

- **Important considerations**
 - “Resident of Hong Kong”
 - Entitlement to tax benefits
- **“Beneficial Owner” requirements for entitlement to tax benefits on certain income**

Name and address of the beneficial owner of the income are requested in the application form IR1313A (03/2018)



INLAND REVENUE DEPARTMENT

Tax Treaty Section
Revenue Tower
5 Gloucester Road
Wan Chai, Hong Kong
GPO Box 10851, Hong Kong
Telephone No. 2594 1500

Application for Certificate of Resident Status Company, Partnership, Trust or other Body of Persons

To : **The Hong Kong Competent Authority**

IRD File No. (if any) _____

I submit an application for a certificate of resident status for the purpose of claiming tax benefits under the Arrangement between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income ("the Arrangement"). (Note 1)

- (1) **Calendar Year(s) of Claim** _____ (Note 2)
- (2) **Information regarding tax benefits under the Arrangement to be claimed in the Mainland**

- (a) Nature and Amount of the Income for each year of claim _____
- (b) Name and Address of the Beneficial Owner of the Income (Note 3) _____
- (c) Tax Identification Number of the Applicant in the Mainland (if any) _____
- (d) Mainland in-charge tax authorities (if known) _____

Conditions for the application of CoR: Substance requirements



Recommendation to strengthen substance in Hong Kong (1/3)

- **The claimant should have a properly functioning Board, with at least two to three Board of Directors meetings to be held in Hong Kong to make strategic decisions in relation to the operation and management of the business**
- **The Board needs to demonstrate that they are overseeing the management of the business**
- **To the extent practical, the Board should consist of majority of Hong Kong resident directors**

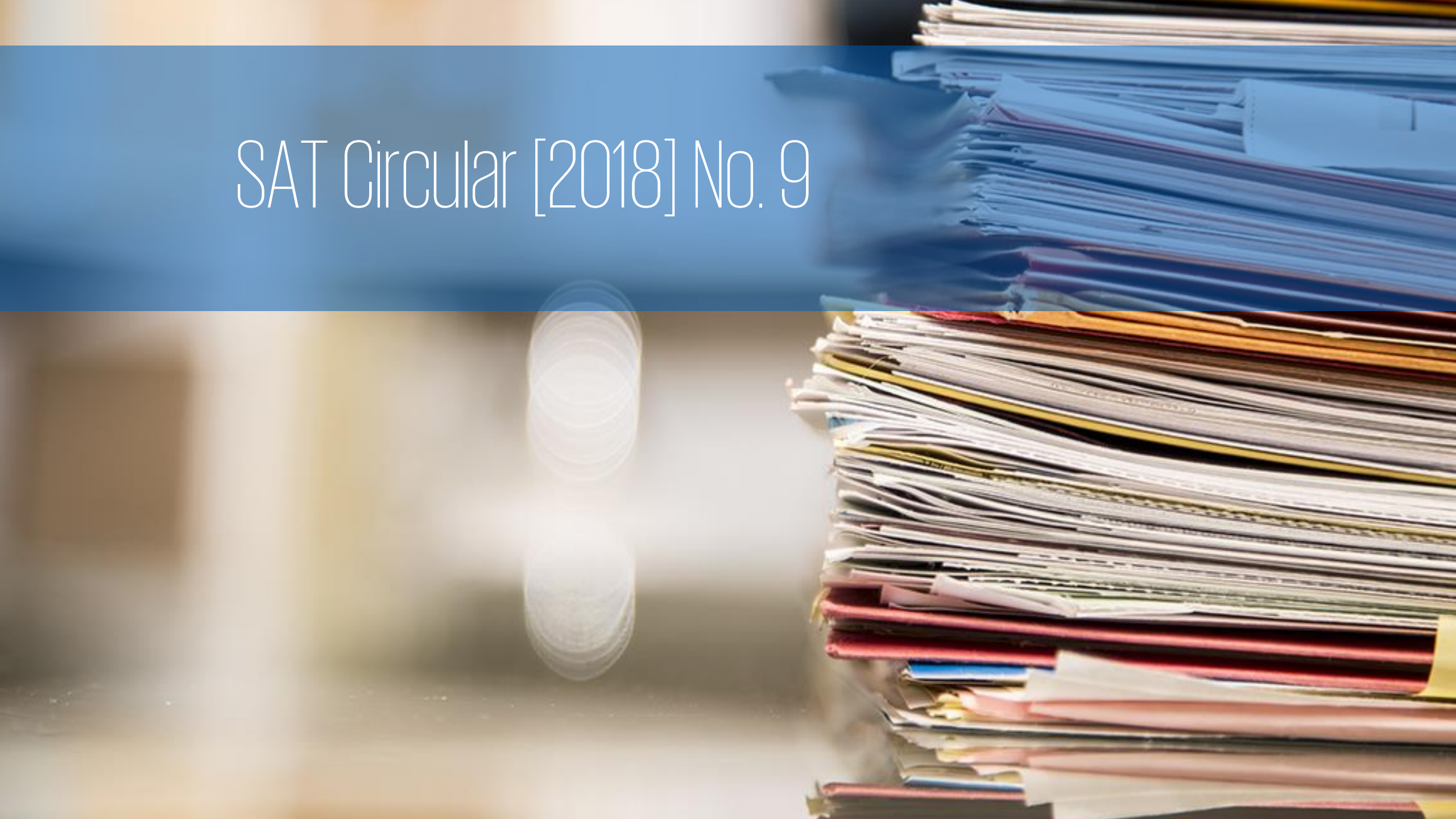
Recommendation to strengthen substance in Hong Kong (2/3)

- **The claimant should incur operating costs pertaining to its operations. For any costs incurred by the affiliated entities, they should be recharged line-by-line so that the relevant portion of expenses is recorded in the claimant's profit and loss account. A proper cost recharge arrangement should be entered between the relevant entities**
- **If possible, staff could be seconded to the claimant to support its day-to-day operations**
- **The claimant should maintain a reasonable debt to equity ratio to the extent practical**

Recommendation to strengthen substance in Hong Kong (3/3)

- **The claimant should maintain a bank account in Hong Kong. Books and records should be maintained in Hong Kong**
- **There should be no contractual obligation to pass on the dividend / gain / interest to the ultimate shareholder or another person**
- **The directors should have the authority to determine when and the amount of distributions**
- **The claimant should specify it has full and discretionary rights to use and enjoy the income without any legal or contractual obligation to pass on the payment received**

SAT Circular [2018] No. 9



Key highlights of SAT Circular [2018] No. 9

- **Clarification of the application of “beneficial ownership”**
- **Changes to “Unfavourable factors”**
- **Broader scope in enjoying treaty benefits on dividends**
 - Extended safe-harbour rule
 - “Derivative benefits” test
- **Clarification of administration procedures on certain measures**

Five unfavourable factors (1/2)

- 1. The resident of the DTA partner who wishes to claim tax benefits (the claimant) has the obligation to pay more than 50% of the income to a resident of a third jurisdiction within 12 months after receiving the income. “Obligation” shall include both a contractual obligation to pay and, in the absence of a contractual obligation, a de facto payment made [“Base erosion test”]**
- 2. The business of activities carried out by the claimant do not constitute substantive business activities. Whether the business activities carried out by the claimant are substantive shall be determined by the functions actually performed and the risks assumed by the claimant [“Substance test”]**
- 3. The DTA partner does not levy tax or grants tax exemption on the relevant income, or levies tax on the relevant income at a very low effective tax rate**

Five unfavourable factors (2/2)

4. In addition to the loan agreement based on which interest arises and is paid, there is another loan agreement or deposit agreement between the creditor and a third party that is similar to the first-mentioned loan agreement in terms of the amount, interest rate, signing date and etc.
5. In addition to the copyright, patent and technology license agreements based on which royalties arise and are paid, there is another licence or transfer agreement between the claimant and a third-party for the right to use or the transfer of the ownership of the relevant copyright, patent or technology

Rules for tax benefits claimed on dividends

Article	Rule
Article 3(1)	Same jurisdiction rule
Article 3(2)	Same treaty benefit rule
Article 4	Safe harbour rule

- **Applicable to dividends**
- **Not applicable to interest or royalties**

Same jurisdiction rule (1/2)



Tax residency certificate required by the Mainland tax authorities:

Claimant

✓

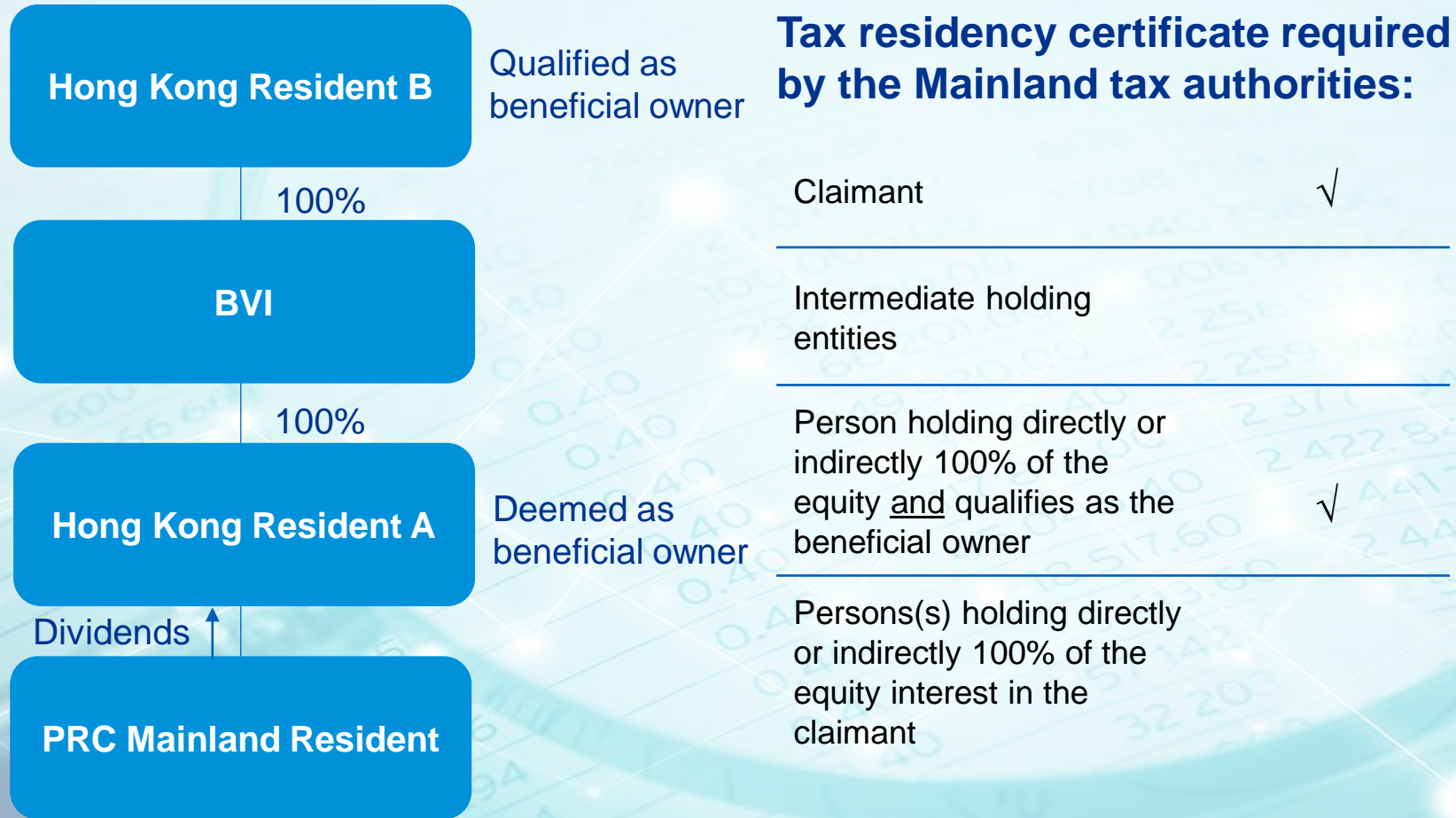
Intermediate holding entities

Person holding directly or indirectly 100% of the equity and qualifies as the beneficial owner

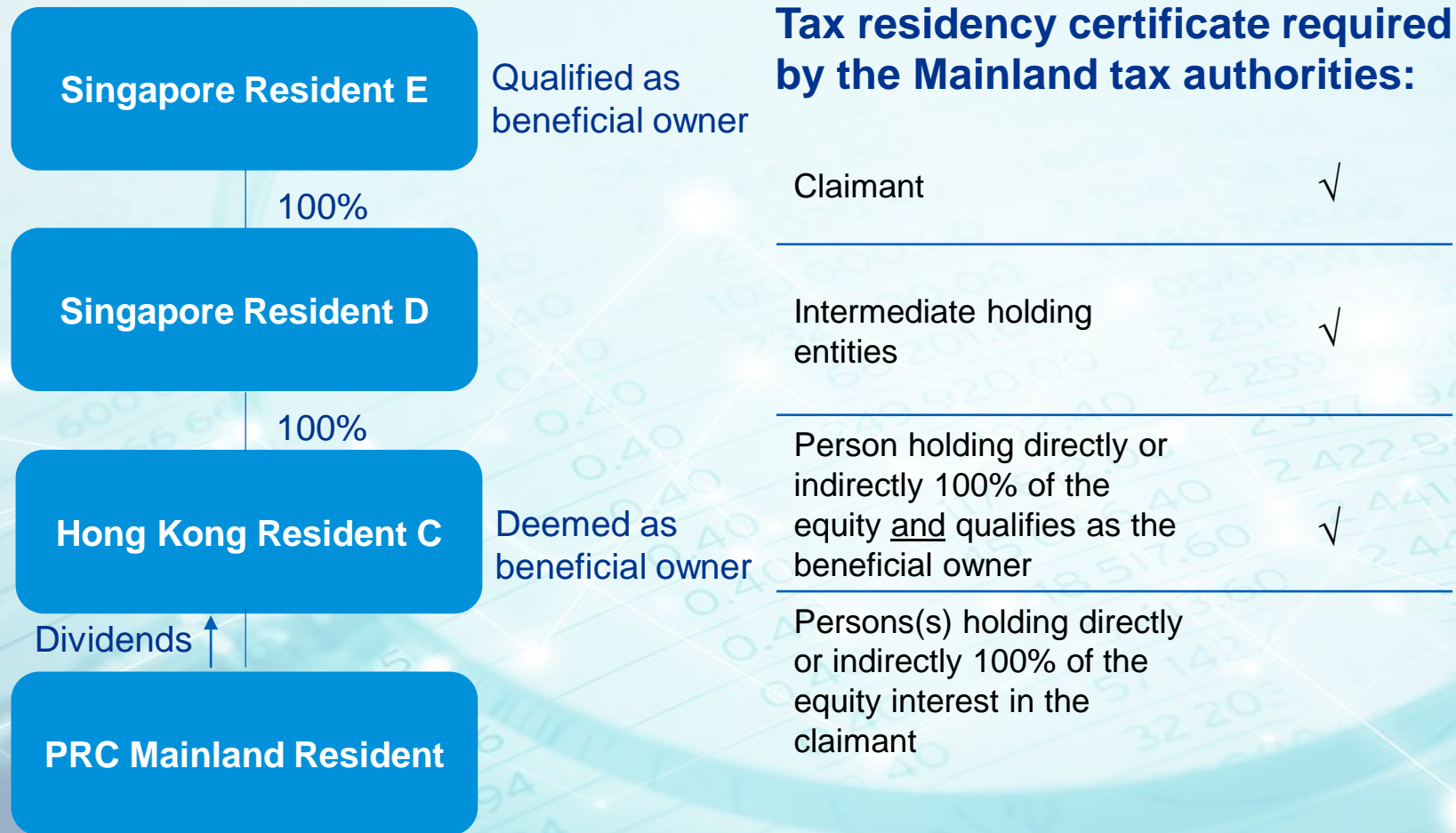
✓

Persons(s) holding directly or indirectly 100% of the equity interest in the claimant

Same jurisdiction rule (2/2)



Same treaty benefit rule

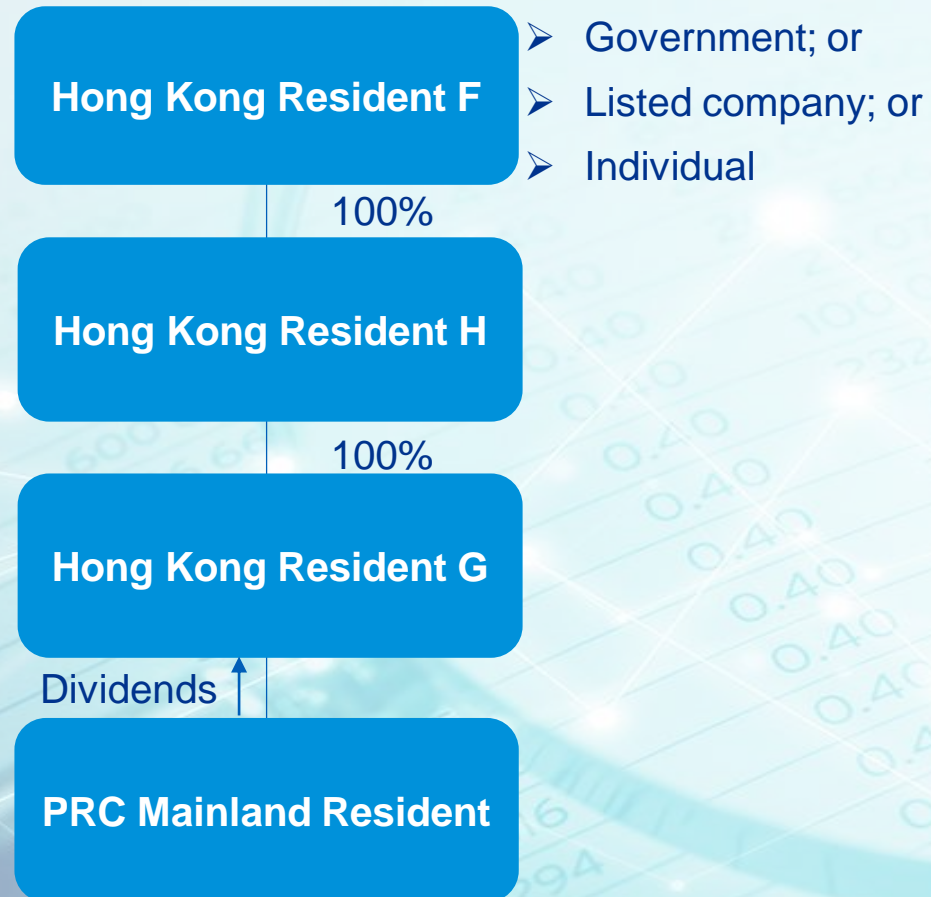


Safe harbour rule (1/3)

The following claimant of tax benefits on dividends can be directly determined as a beneficial owner without the need to analyse the factors provided for in Article 2:

- The Government of the DTA partner;
- A company that is a resident of and listed in the DTA partner;
- An individual who is a resident of the DTA partner;
- A claimant whose equity interest is directly or indirectly 100% held by one or more of the persons specified above and, in the case of indirect holding, the intermediate holding entities are residents of the Mainland or residents of the DTA partner

Safe Harbour Rule (2/3)



Tax residency certificate required by the Mainland tax authorities:

Claimant

✓

Intermediate holding entities

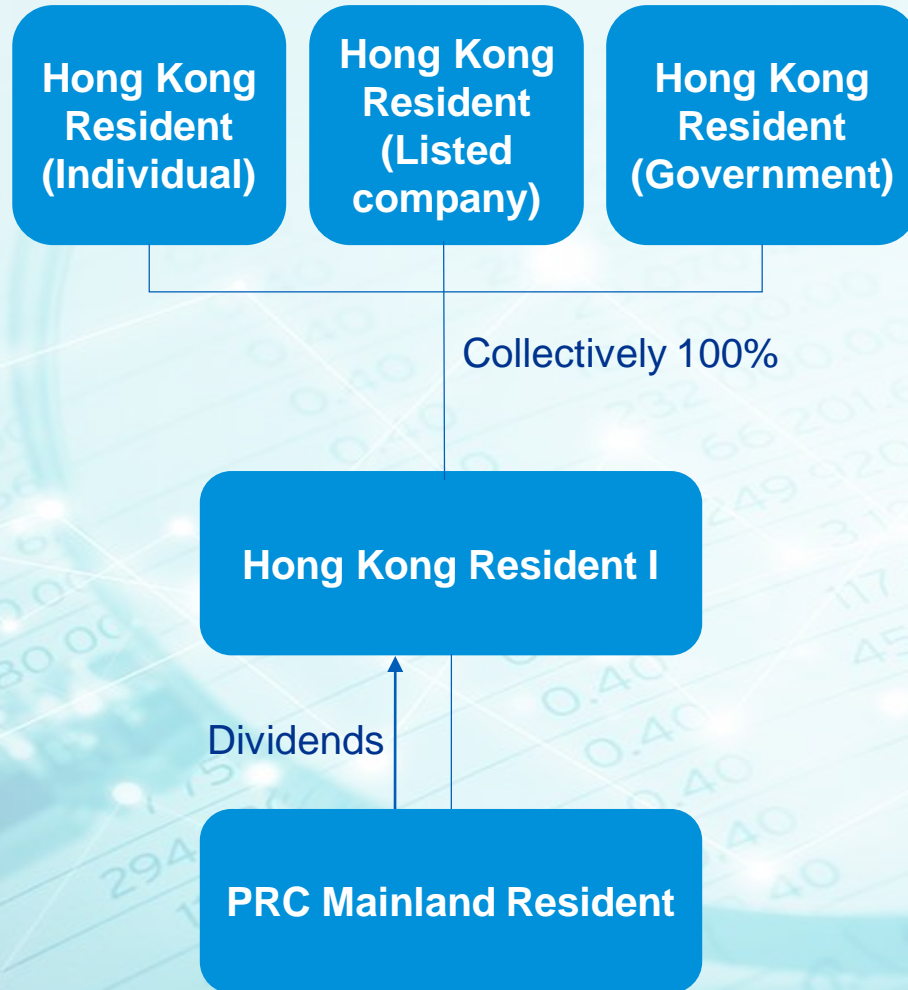
✓

Person holding directly or indirectly 100% of the equity and qualifies as the beneficial owner

Persons(s) holding directly or indirectly 100% of the equity interest in the claimant

✓

Safe Harbour Rule (3/3)



Tax residency certificate required by the Mainland tax authorities:

Claimant

✓

Intermediate holding entities

✓

Person holding directly or indirectly 100% of the equity and qualifies as the beneficial owner

Persons(s) holding directly or indirectly 100% of the equity interest in the claimant

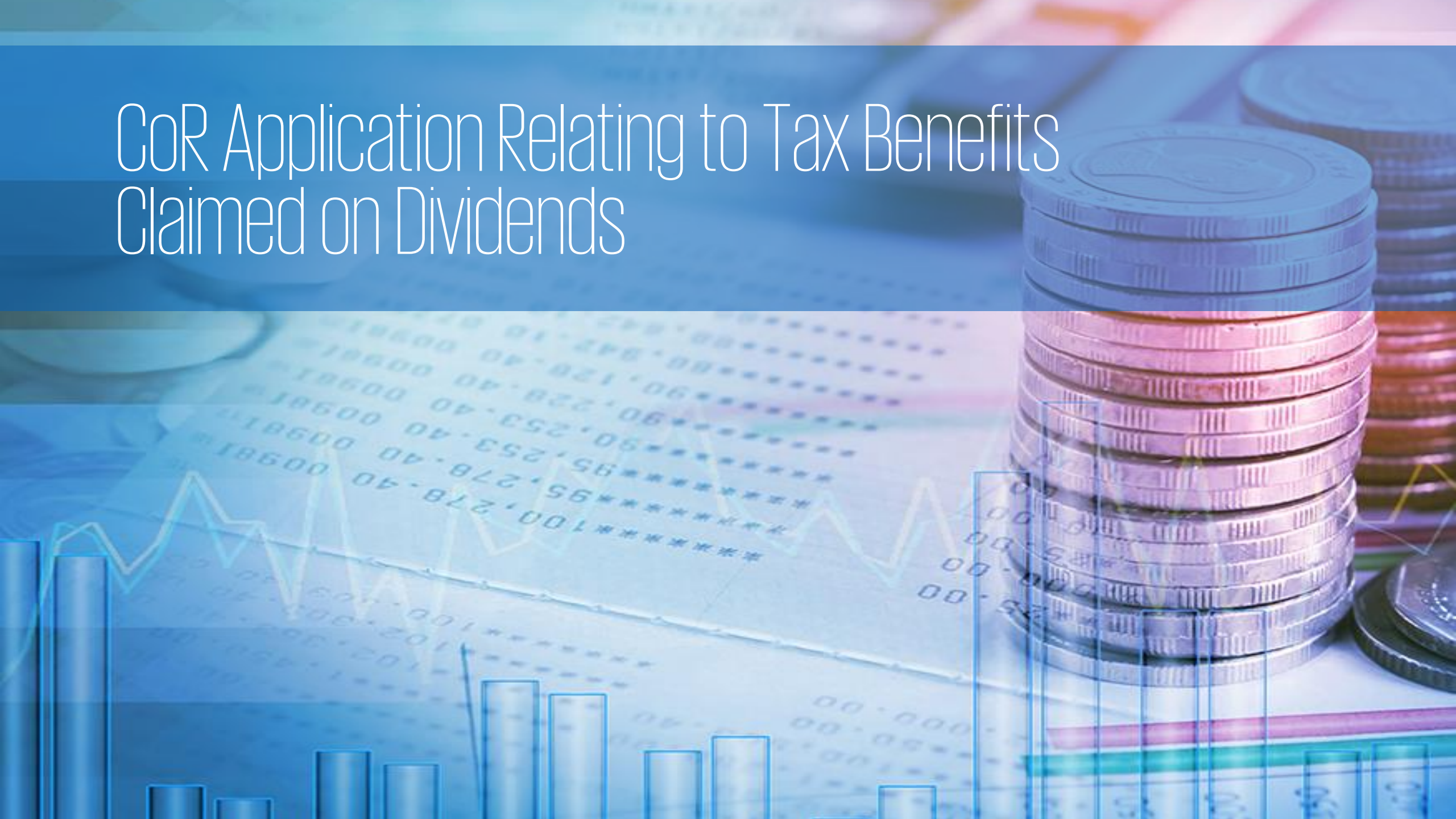
✓

Tax residency certificate

Tax residency certificate required by the Mainland tax authorities:

	"Same jurisdiction rule" Article 3(1)	"Same tax treaty rule" Article 3(2)	"Safe harbour rule" Article 4
Claimant	√	√	√
Intermediate holding entities		√	√
Person holding directly or indirectly 100% of the equity and qualifies as the beneficial owner	√	√	
Persons(s) holding directly or indirectly 100% of the equity interest in the claimant			√

CoR Application Relating to Tax Benefits Claimed on Dividends



Updates to CoR application

- **IRD will take into account the SAT Circular [2018] No.9 when processing CoR applications, particularly:**
 - The rules on “beneficial owner” in Articles 3(1), 3(2) and 4
 - The need for tax residency certificates for multiple entities in a holding chain
- **Revised application form IR1313A has been revised in March 2018 after discussions with the SAT**
- **Interim measures**
- **Further updates will be made available at the IRD’s website as and when appropriate**

Interim measures (1/2)

- **For tax benefits claimed on dividends in the Mainland falling within Articles 3(1), 3(2) and 4 of the SAT Circular [2018] No.9**
- **Submit CoR applications of the lead applicant and co-applicants in a bundle**
- **Designate an applicant (not being an individual) as the lead applicant, who will provide information on the relevant multi-level holding structure and serve as the primary point of contact on behalf of all the applicants**
- **The lead applicant and each of the co-applicants should fill in their own CoR application form**

Interim measures (2/2)

- **Information to be provided by all applicants:**
 - The applicable article number of the SAT Circular [2018] No.9 (i.e. Article 3(1), 3(2) or 4)
 - Basic particulars (name, address and business registration number) of the lead applicant
- **Information to be provided by the lead applicant:**
 - A chart of the relevant multi-level holding structure
 - Basic particulars of each person in the chart
 - Confirmation of any change in equity interest of any person in the chart during the 12 consecutive months before dividends were / are to be received

Information to be provided (1/3)

A chart of the relevant multi-level holding structure showing the following:

- The equity interest of the immediate recipient of dividends is directly or indirectly 100% owned by:
 - The beneficial owner of the dividends; or
 - Government, listed company and/or individual
- The equity interest held by the person(s) at each level of the structure

Information to be provided (2/3)

Particulars for each person in the chart: (other than the lead applicant and co-applicants)

	Article 3(1)	Article 3(2)	Article 4
Name and address	√	√	√
Place and date of incorporation / establishment (if applicable)	√	√	√
Identification (e.g. Business registration number / registration number/ HKID card number/ passport number)		√	√
Stock code of the Hong Kong Stock Exchange (if applicable)		√	√
Jurisdiction of residence		√	√

Information to be provided (3/3)

Name and address of the beneficial owner of the income to be provided in the application form IR1313A (03/2018):

Article	Beneficial Owner
Article 3(1) or 3(2)	The person who holds directly or indirectly 100% of the equity interest in the claimant and is the beneficial owner determine in accordance with the provisions of Article 2 of the SAT Circular [2018] No.9
Article 4	The claimant itself

Q & A Session



Thank You

Contact Details:

Sandy Fung

*Tax Partner
Alternative Investments
KPMG Tax Services Limited*

Tel: +852 2143 8821
Email: sandy.fung@kpmg.com

Anthony Pak

*Tax Director
M&A Tax
KPMG Tax Services Limited*

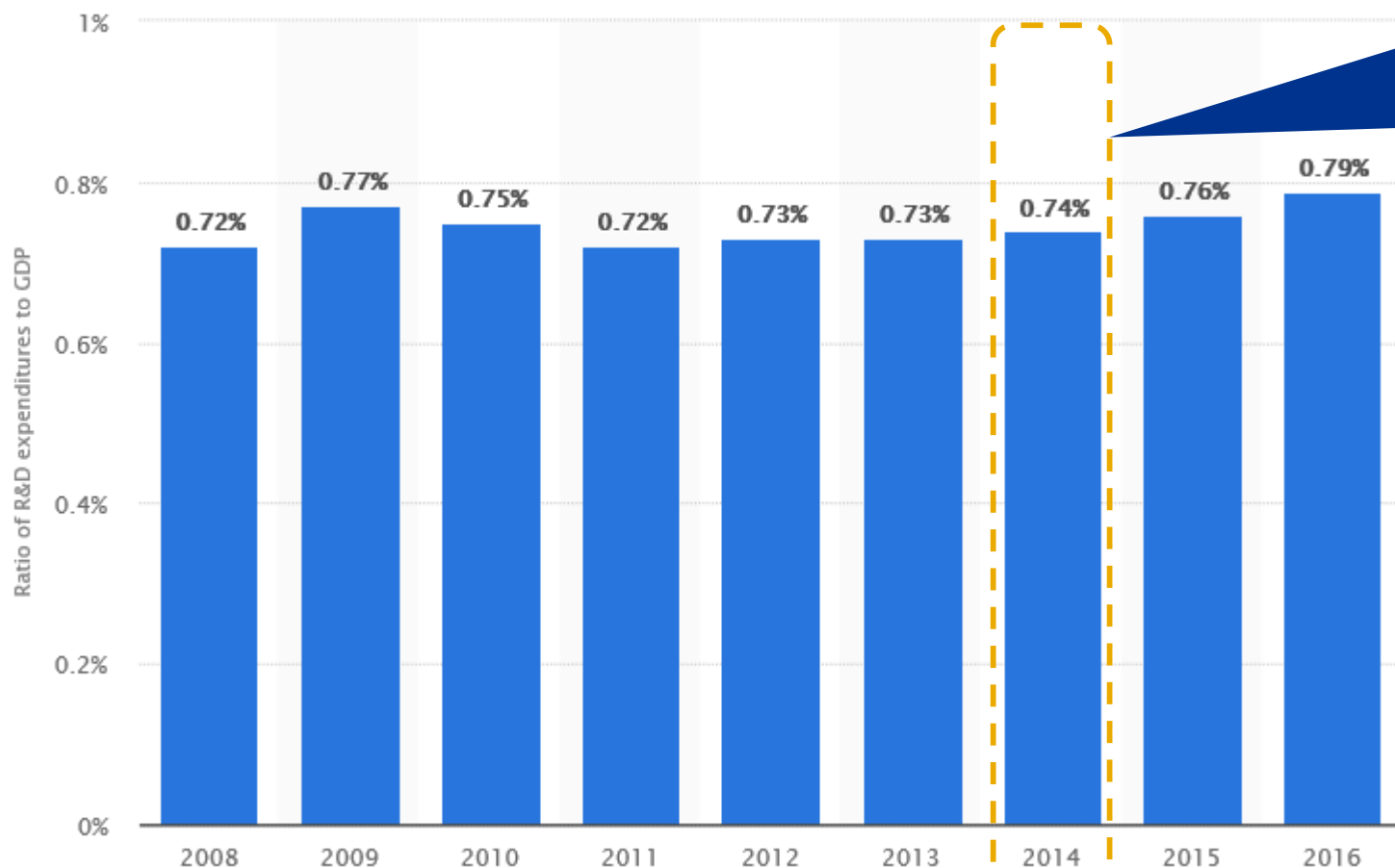
Tel: +852 2847 5088
Email: Anthony.pak@kpmg.com

The background of the slide is a close-up photograph of a fingerprint scanner. A finger is positioned over the scanner, which has a glowing green ring around the sensor area. The image is slightly blurred, focusing on the scanner and the finger.

Research and Development in Hong Kong

John Timpany, Alex Lai
31 July 2019

Ratio of R&D Expenditure to GDP in Hong Kong



Source: Statista.com

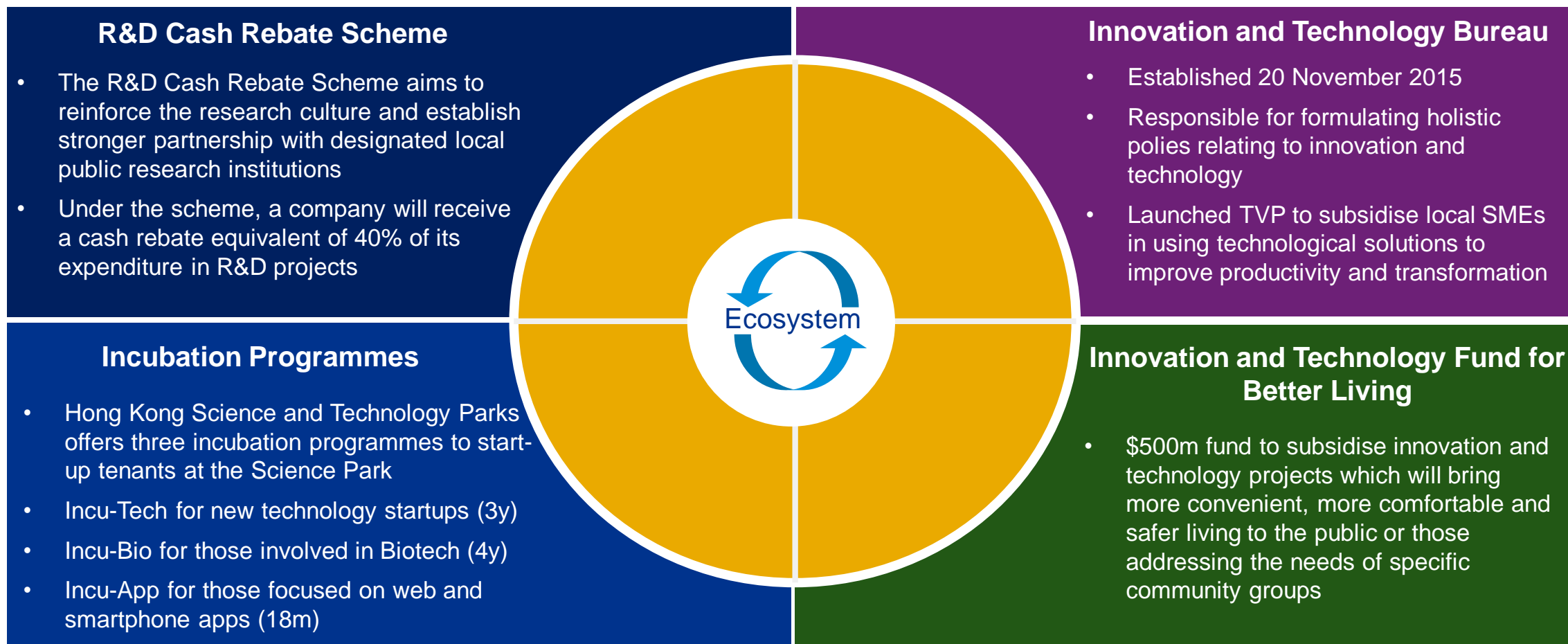
Broad Composition (2014) (HKD Mn)

Business Sector	0.33%	7,437
Higher Education Sector	0.38%	8,632
Government Sector	0.03%	658
Total	0.74%	16,727

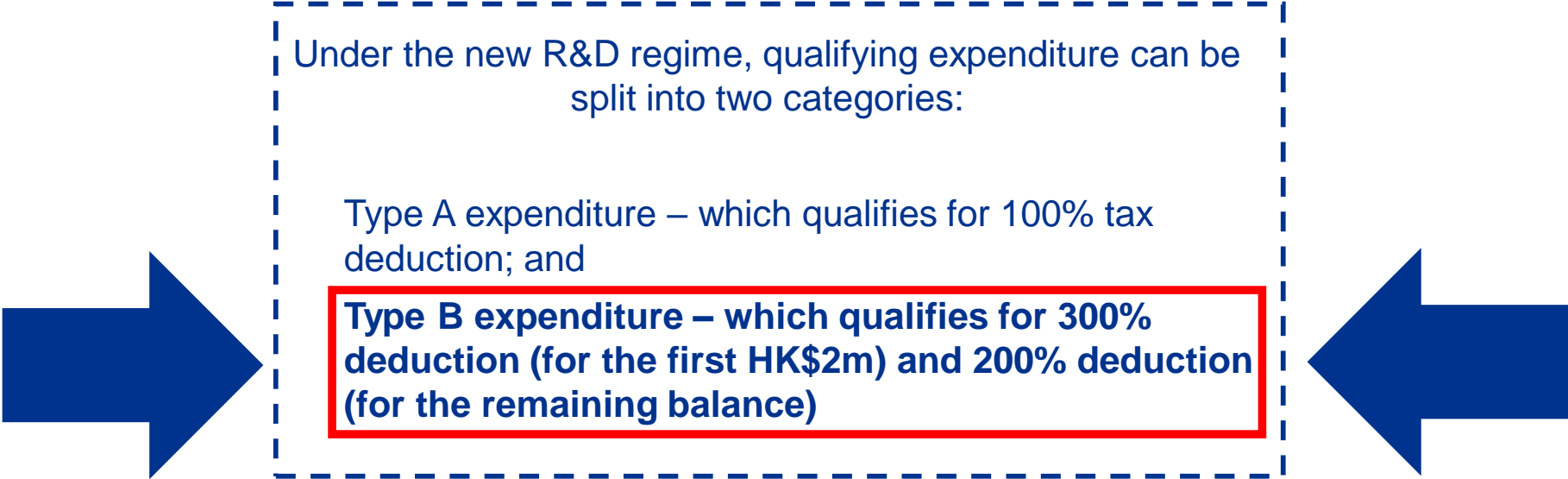
Business Sector Breakdown

Manufacturing	1.5%
Import / export and wholesale	
retail, accommodation and food	29.0%
Information and communications	3.5%
Financing, insurance, real estate	27.4%
Others	38.6%

Hong Kong's Research and Development Ecosystem



The R&D Enhanced Deductions



Under the new R&D regime, qualifying expenditure can be split into two categories:

Type A expenditure – which qualifies for 100% tax deduction; and

Type B expenditure – which qualifies for 300% deduction (for the first HK\$2m) and 200% deduction (for the remaining balance)

The R&D Regime - Type B



DIPN 55 – Deduction for R&D Expenditure

Key Insights

- Definition of Research and Development
- Explores the concepts of “substantially improved” and “advance in science or technology”
- Involvement of the ITC
- Typical phases of a R&D project and eligibility to claim deductions under these phases
- Qualifying expenses and apportionment of “staff costs”
- Vested benefit of the IP
- Cost Contribution Arrangements
- Supporting documentation



Inland Revenue Department
Hong Kong

DEPARTMENTAL INTERPRETATION AND PRACTICE NOTES

NO. 55

DEDUCTION FOR RESEARCH AND DEVELOPMENT EXPENDITURE

These notes are issued for the information of taxpayers and their tax representatives. They contain the Department's interpretation and practices in relation to the law as it stood at the date of publication. Taxpayers are reminded that their right of objection against the assessment and their right of appeal to the Commissioner, the Board of Review or the Court are not affected by the application of these notes.

WONG Kuen-fai
Commissioner of Inland Revenue

April 2019

Our website : www.ird.gov.hk

Real Life Examples - TMT

TMT



- Telecom network monitoring for faults and black spot elimination
- Development of a predictive network technology and traffic re-routing
- Real time suspicious activity monitoring
- Increasing mobile network data traffic volumes whilst maintaining high speeds
- Creation of a new data encryption method that is more secure than existing encryption methods, yet requires less computing resources to encrypt and decrypt
- Creating a robust speech-to-text application with a self-learning capability that provides for fast adaptation to a new speaker
- Technology capable of re-ordering perishable items in refrigerators for domestic and industrial application



Bilateral APA Process and Timeline

Karmen Yeung
26 August 2019



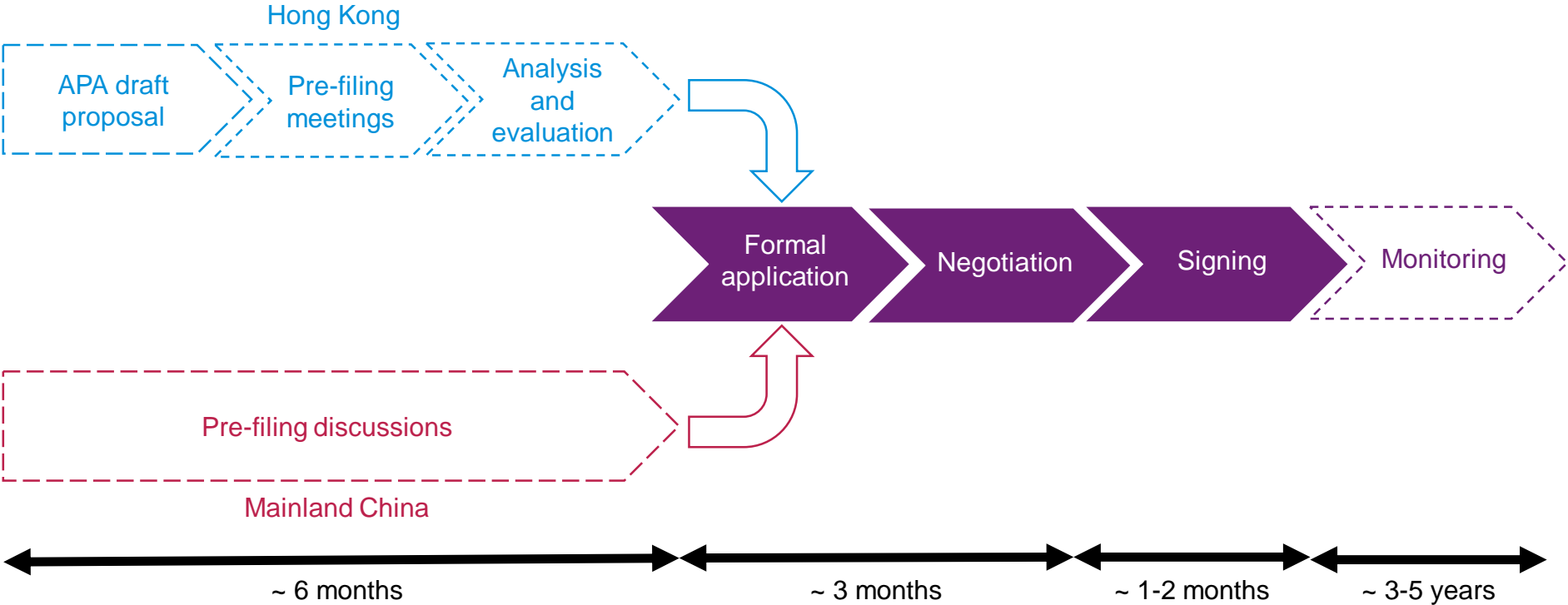
Transfer Pricing In Hong Kong



Benefits of APA

- Greater certainty
- No double taxation
- Arm's length principle
- Proactive management of TP risks
- Reduce potential tax audit costs and penalties

A case study



Challenges of APA

- Extensive information and resources required
- Lengthy negotiation
- Validity of critical assumptions
- May expose historical TP risks
- Tax authorities' resources constraints

Appendix



Bilateral APA process

	Hong Kong	Mainland China
Basis of application	<ul style="list-style-type: none"> Part 8AA Division 4 of the Inland Revenue Ordinance (s50AAP – s50AAW) Departmental Interpretation and Practice Notes No. 48 (“DIPN 48”) issued by the HK Inland Revenue Department (“IRD”) 	<ul style="list-style-type: none"> Announcement on Enhancement of Administration of Advance Pricing Arrangement (“Announcement 64”) issued by the State Administration of Taxation in China (“SAT”)
Application Threshold	<ul style="list-style-type: none"> Threshold for <i>each year</i> covered in the APA: <ul style="list-style-type: none"> ➢ HKD 80 million for sale and purchase of goods ➢ HKD 40 million for services ➢ HKD 20 million for use of intangible properties IRD may consider the number and relative size of the transactions, transfer pricing risk etc. and relax the eligibility criteria for APA application 	<ul style="list-style-type: none"> APA is generally available for application where an enterprise with annual related party transaction amount exceeding RMB 40 million for the three years prior to the year in which the “Notice on Tax Matters” is issued by the in-charge tax administration notifying the acceptance of enterprise’
Normal Term	<ul style="list-style-type: none"> Covers a period of three to five years 	<ul style="list-style-type: none"> Covers a period of three to five years
Overall Time Needed / Suggested by the authority	<ul style="list-style-type: none"> IRD suggests the tentative timeframe for concluding an APA is 18 months from the acceptance of the formal application The timeframe would depend on the progress of negotiation with the competent authority of the DTA partner, which could take an extra 6 months depending on the scheduling of the competent authority meeting concerned A longer timeframe may be required in more complex cases 	<ul style="list-style-type: none"> SAT has not provided a timeframe regarding the conclusion of APA cases Based on statistics as stated in the China Advance Pricing Arrangement Report (2015), around 50% of the bilateral APA cases were concluded within 1 year, 16% took 1 to 2 years, 16% took 2 to 3 years, and the remaining 18% were concluded in more than 3 years



Thank you