Preface to 2016–17 Edition

From a tax perspective, the year to the end of June 2016 was a relatively busy one for Hong Kong's tax system. Obviously, the G20 and OECD's BEPS project has been massively relevant internationally. Back at home, the Hong Kong government has been actively pursuing strategies to ensure that Hong Kong remains a competitive international financial centre, while also remaining compliant insofar as global tax initiatives are concerned.

In June 2016, legislation was passed enabling Hong Kong to implement the latest global standard for automatic exchange of financial account information. From 1 January 2017, the OECD's Common Reporting Standard will be effective in Hong Kong. Already over 100 jurisdictions have committed to this standard which will see reporting financial institutions headquartered or having operations in these jurisdictions instituting stringent processes and procedures to meet their reporting obligations. Under this framework, reporting financial institutions in Hong Kong will be obliged to identify and report to the Inland Revenue Department financial accounts held by tax residents of overseas reportable jurisdictions on an annual basis commencing in 2018.

Legislation was also enacted to extend the profits tax exemption for offshore funds to offshore private equity funds retrospectively from 1 April 2015. The Inland Revenue Department has issued new Departmental Interpretation and Practice Notes (DIPN) No. 51 which sets out its interpretation and proposed practice in relation to these provisions, while an existing DIPN (No. 43) has been revised accordingly.

The Inland Revenue (Amendment) (No. 2) Ordinance 2016 was passed in May of this year, and is one of the more significant pieces of tax legislation in recent years. It introduces incentives for multinational corporations to establish Corporate Treasury Centres (CTCs) in Hong Kong. The key tax incentive provides for a concessionary halved profits tax rate (8.25%

currently) to those taxpayers meeting a number of conditions. Furthermore, and rectifying a previous tax anomaly, a deduction is now permissible where a corporation carries on an intra-group financing business and incurs interest expenses on money borrowed, in the ordinary course of that business, from non–Hong Kong associated corporations. Correspondingly, the legislation provides for the taxation of interest that arises from the carrying on of an intra-group financing business in Hong Kong, notwithstanding the source of such interest and profits are outside Hong Kong. In effect, this would appear to codify the "operations test" for determining the source of interest income for corporations carrying on an inter-group financing business, which found favour in the 1997 Privy Council decision in the *Orion Caribbean* case. It is expected that the Hong Kong tax authorities will issue a DIPN to clarify a number of pertinent issues that arose during the progress of this legislation through the Legislative Council.

The second part of this 2016 amendment dealt with uncertain tax positions in respect of income/expenses related to regulatory capital securities that are issued by banks to strengthen their capital base within the Basel III capital adequacy requirements. It is also anticipated that there will be a DIPN specifically dealing with this new legislation.

In June 2016, the Securities and Futures (Amendment) Ordinance 2016 was passed by the Legislative Council which introduced a legal, regulatory and tax framework for an open-ended fund company (OFC) regime in Hong Kong. This provides for an alternative form of vehicle for open-ended funds domiciled in Hong Kong, under which the profits tax and stamp duty treatments will be the same as those for unit trusts.

During the year, there were relatively few tax cases heard by the Board of Review or the courts. This may be exacerbated even more by amendments to the operation of the Board of Review and a new appeal process introduced by the Inland Revenue (Amendment) Ordinance (No. 3) 2015 which became effective in 2016. In particular, the Case Stated procedure, which has been the manner by which decisions of the Board of Review could be reviewed by either the Court of First Instance or the Court of Appeal, has been abolished and replaced with a more effective appeals process whereby either party may appeal a decision of the Board directly to either the Court of First Instance or the Court of Appeal on questions of law.

Towards the end of 2015, the OECD released the final reports on the 15 action items of the G20 and OECD's BEPS initiative. The BEPS project began in 2013 and has received unprecedented attention from both governments and the private sector. These final reports outline the OECD's recommendations as well as the participant countries' consensus for addressing each of the 15 specific actions identified in the BEPS Action Plan. Over 60 jurisdictions collaborated in the BEPS project, and they have all agreed to continue working on the project until at least 2020. The project has, however, extended beyond this and many more jurisdictions have actively participated in shaping the outcomes through regional structured dialogues, such as meetings in Asia Pacific held under the auspices of the OECD.

Hong Kong is publicly committed to the OECD's BEPS framework via its recent status as a BEPS Associate, which means it has equal footing with the OECD, G20 and other countries to implement the BEPS package and to develop associated standards. In doing so, Hong Kong has committed itself to the BEPS package and its consistent implementation, which includes the current four minimum standards: countering harmful tax practices, preventing tax treaty abuse, introducing Country-by-Country reporting, and improving cross-border tax dispute resolution.

Hong Kong's involvement in the BEPS project is welcome and could conceivably affect taxpayers in the future with regard to their structure and business operations together with the requirements of enhanced compliance. The government has indicated that it will review the current domestic tax regime and determine to what extent Hong Kong needs to adjust to meet the new global standards and expectations.

Hong Kong also continues to expand its Double Tax Agreement network and currently has concluded 35 agreements with a further 11 under negotiation. Hong Kong also has 7 effective Tax Information Exchange Agreements. In 2015, Hong Kong and Mainland China signed a protocol to the existing tax agreement between the two jurisdictions providing for, among other things, tax exemptions in the Mainland for gains derived by Hong Kong tax residents from the disposal of shares in Chinese resident companies listed on stock exchanges under specific conditions, reducing the withholding tax to just 5% for income from aircraft leasing and ship chartering and the introduction of a main purpose *test* as an anti-treaty abuse measure.

It is expected that the coming years will be exciting for tax in Hong Kong. Certainly, we expect 2016 and 2017 to be dominated by BEPS and by added compliance for taxpayers through the introduction of global initiatives, such as Automatic Exchange of Information and Country-by-Country reporting.

This year's edition of the book sees a slight departure from previous years. For the first time, we have introduced footnotes which, it is hoped, will ensure that the book remains concise and easy to read. We have also looked to enhance the presentation of the citations for Board of Review and Court decisions to enable easy access to the actual decisions. There is also a new chapter on special provisions that we will look to expand in coming editions.

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