Preface to 2018–19 Edition

The year to the end of July 2018 is one of the busiest years we have ever experienced in Hong Kong in terms of tax changes. This was due to the OECD's and G20's twin projects dealing with BEPS (base erosion and profit shifting, which aims to change the global tax landscape by reducing the potential for cross-border tax avoidance) and CRS (common reporting standard, which provides for automatic exchange of information concerning financial accounts between more than 100 jurisdictions). The changes that have been made, and will continue to be made, as a result of these projects have affected many jurisdictions besides just Hong Kong. Hong Kong cannot afford to be outside this process, and the Hong Kong government is keen to ensure that it complies with these global initiatives so that Hong Kong is not viewed as an outlier. Hong Kong also does not wish to be perceived as an un-cooperative jurisdiction which in turn could result in Hong Kong being "named and shamed" in OECD and EU blacklists and thereby possibly subjected to sanctions by the international tax community.

Although Hong Kong has adopted these initiatives, more recently, it has been criticized for being slow in implementing the necessary changes. Much of this was because Hong Kong could not sign many of the multilateral agreements for effecting the necessary changes, due to the fact that it is not a state in its own right but a "special administrative region" within the PRC. This initially required Hong Kong to agree changes with other countries on the basis of bilateral negotiations which, of course, is a much slower process than agreeing to changes on a faster multilateral basis. In order to accelerate this process, the Hong Kong government recently secured the agreement of the PRC to have the motherland sign the relevant international conventions on Hong Kong's behalf. As a result, Hong Kong has become a party to the all-encompassing Multilateral Convention on Mutual Administrative Assistance in Tax Matters, and legislation was enacted to enable this procedure in early 2018. This means that the implementation of the BEPS and CRS initiatives through multilateral competent authority agreements will occur much more quickly than was previously contemplated, in line with implementation schedules mandated by the OECD and EU and applying around the world.

The government issued its formal response to the BEPS consultation exercise in July 2017. This led to the enactment of a transfer pricing regime in Hong Kong in mid-2018. This represents a significant change for Hong Kong. In addition, the legislation contained the necessary provisions to implement the BEPS four "minimum standards" into Hong Kong's tax law. Finally, the government has taken the necessary steps to implement spontaneous exchanges of tax rulings as mandated by the BEPS project.

In July 2017, legislation came into force to enable Hong Kong to implement CRS in respect of 72 jurisdictions, in addition to the three countries that had already been provided for. Financial accounts information as from 1 July 2017 will be exchanged with these other countries in September 2018. Recently, a further 51 countries were added to this list. The necessary computer portal for financial institutions to report data to the tax authorities became operational in July 2017, and so Hong Kong is "all set to go" so far as CRS and financial account reporting are concerned.

Hong Kong remains committed to expanding her tax treaty network, and the priority at this stage is to focus on countries that are within the geographic scope of the PRC's belt and road initiative. More treaties are expected in the coming year. In June 2017, Hong Kong was an original signatory to the multilateral instrument that was signed in June 2017 to amend global tax treaties, through the mechanism of the PRC signing on Hong Kong's behalf. The necessary legislation to effect these amendments to Hong Kong's tax treaties was enacted in 2018.

Legislation was enacted in July 2017 to provide for a concessionary tax regime applying to aircraft lessors and aircraft leasing managers. The first draft of the bill was in fact amended after comments were received from the OECD that the original proposal would constitute an objectionable harmful tax practice in violation of BEPS guidelines. In particular, ring-fencing provisions were removed which would have favoured leases to airlines outside Hong Kong over leases to airlines operating within Hong Kong. Legislation was also introduced to remove certain features which the OECD has suggested constitute harmful tax practices in connection with Hong Kong's concessional tax regimes for captive insurers, reinsurers and corporate treasury centres. These changes demonstrate Hong Kong's commitment to comply with the BEPS initiatives. Over the coming years, we can expect to see more changes to Hong Kong's tax system to ensure greater compliance with the emerging global tax norms.

A new concessionary tax regime was introduced in 2018 for open-ended fund companies (essentially, mutual fund companies), following on from the creation of such entities last year.

The government recently introduced a two-tier profits tax rate, and increased the scope of intellectual property rights the cost of which now qualifies for amortization for tax purposes. In the coming months, the rules providing for deduction of research and development expenditure will be significantly enhanced; a new concessionary deduction will be introduced for health insurance premiums; married couples will soon become entitled to file for personal assessment separately instead of jointly; and further tax concessions will be introduced for short-term debt instruments. All in all, the legislature is very busy dealing with these (and soon, with even more) tax amendments.

The number of Board of Review cases and court cases has reduced drastically over recent years, as taxpayers appear to be more willing to settle their disputes with the tax authorities rather than proceed to formal litigation.

Finally, the government has established a Tax Policy Unit within its Financial Services & Treasury Bureau. We will wait and see whether this develops into a full-blown tax policy unit that functions separately from the tax administration.

This book is revised and republished annually. This year's edition includes inevitable tidying up as well as new provisions dealing with recent legislative amendments. Some of the chapters have been reordered. The authors appreciate that changes should be avoided where possible, but some meaningful changes are called for. We do not pretend that we have got everything right, and there will be more changes over coming years to make this book more user-friendly. We would be very grateful for readers to provide feedback to us if they spot typos, errors or have suggestions for improvements, by contacting us at hktaxationguide.hk@kpmg.com.

Ayesha Macpherson Lau
hktaxationguide.hk@kpmg.com
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