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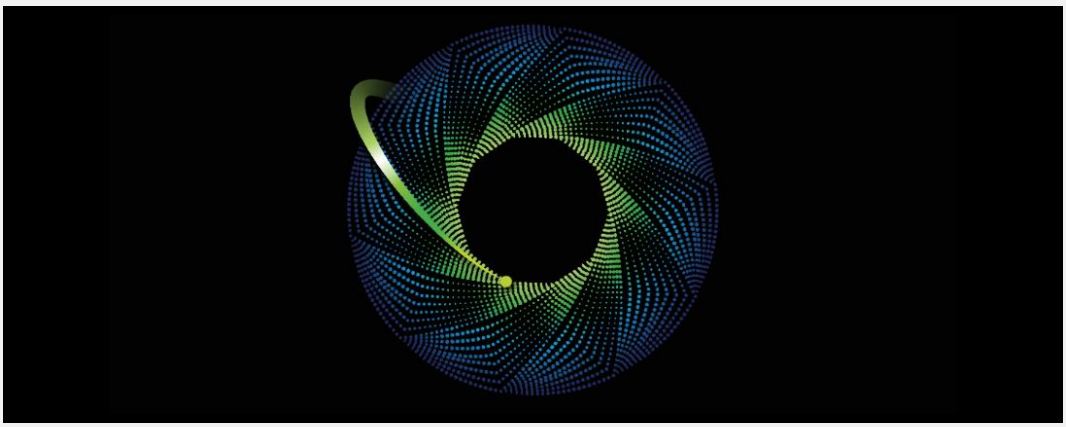

# Hong Kong Tax Newsflash

# Inland Revenue Department issued guidance (DIPN) on court-free amalgamation and transfer of assets without sale

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The Inland Revenue Department (IRD) recently issued the Departmental Interpretation and Practice Notes No.63 (DIPN 63) on qualifying amalgamation of companies and transfer or succession of specified assets without sale, setting out its views and practices with illustrative examples. DIPN 63 also listed out the information and documents required for applying an advance ruling about qualifying amalgamation. It supplements the relevant guidelines posted in the IRD's website with the latest update in 2021.

In this article, we will highlight some of the key points contained in DIPN 63. For the detailed tax treatments for court-free amalgamation and transfer of assets without sale, please refer to our previous articles[1].

### Qualifying amalgamation

A qualifying amalgamation refers to any amalgamation of companies within a group under the Companies Ordinance (CO), either in the form of vertical amalgamation (i.e., between a holding company and its wholly owned subsidiaries) or horizontal amalgamation (i.e., between wholly owned subsidiaries of a body corporate). Under the CO, only Hong Kong

incorporated companies can be amalgamated under the court-free amalgamation procedure.

## Election for special tax treatments

The special tax treatments for qualifying amalgamation only apply upon election. Once the election is made, the amalgamated company is treated as having succeeded to all the assets of the amalgamating company. Any balance of allowances or deductions allowable in respect of such assets could continue to be claimed by the amalgamated company, subject to certain conditions. On the subsequent sale of the assets, the deductions allowed or allowances made to both the amalgamated company and amalgamating companies would be taken into account when computing the amount chargeable to profits tax. The special tax treatments for qualifying amalgamation are summarized in Appendix 2 to DIPN 63.

If no election is made, any unabsorbed loss of the amalgamating company will lapse and any assets succeeded from the amalgamating company will be deemed to have been sold at the lower of the open market value of the asset and the capital expenditure incurred or deductions allowed.

## Pre-amalgamation loss

The conditions for the set off of pre-amalgamation losses of the amalgamating and amalgamated company are summarized below:

| Loss of amalgamating company | Loss of amalgamated company |
|---|---|
| Post entry condition[2] | Post entry condition |
| Same trade condition | Financial resources condition |
| CIR's satisfaction condition[3] | Trade continuation condition[4] |
| | CIR's satisfaction condition |

## Same trade condition

DIPN 63 stipulated that in determining whether the "same trade condition" is met, all facts (e.g., business model, operating style, and registered brand, etc.) would be considered. It also included some examples to illustrate whether the same trade condition would be regarded as satisfied under different circumstances. Some of these examples are the same as those in the IRD's website[5].

It is worth noting that the IRD has provided a new example of "same trade condition" in DIPN 63 based on the background of Example 1 in its website.

Company J1 operated a Japanese restaurant (Restaurant 1) with losses. It amalgamated with Company J2 which operated an Italian restaurant. Company J2 became the amalgamated company.

In Example 11 of DIPN 63, immediately after the amalgamation, Company J2 converted Restaurant 1 into a restaurant serving both Japanese food and Italian food without changing the tradename. Apart from the change in the cuisines, there were no significant changes in the business model of Restaurant 1. The IRD is of the view that the "same

trade condition" would be met as there were no significant differences in the mode of operations. Restaurant 1 would not be regarded as operating a different business simply because of the change in cuisines.

As compared to Example 1 in the IRD's website, this new example provides clarification and highlights the importance of using the same tradename. The comparison of the examples are set out below:

| | Restaurant 1 | | | Same trade condition |
|---|---|---|---|---|
| | Pre-amalgamation | Post-amalgamation | | |
| 1 | Japanese food | Japanese & Italian food | same tradename (J1) | ✓ |
| 2 | Japanese food | Italian food | different tradename (J2) | ✗ |
| 3 | Japanese food | 50% Japanese restaurant | same tradename (J1) | Partial (tax loss can only set off profits from Japanese restaurant) |
| | | 50% Italian restaurant | different tradename (J2) | |

*Scenario 1 – DIPN 63 Example 11*
*Scenario 2 – IRD's website Example 1 part 1 (not included in DIPN 63)*
*Scenario 3 – IRD's website Example 1 part 2 (not included in DIPN 63)*

## Financial resources condition

The amalgamated company (with tax loss) is required to have adequate financial resources immediately before the amalgamation to purchase the business of the amalgamating company. However, financial resources do not include intra-group loan. In DIPN 63, the IRD clarified that financial assistance provided by a parent company to its subsidiary during day-to-day operations or normal trading transactions between two companies would not be regarded as intra-group loan for the purpose of financial resources condition.

## Our comments

Although DIPN 63 is not legally binding, it provides detailed guidance on the special tax treatments for qualifying amalgamation. The illustrative examples and summary of special tax treatments for qualifying amalgamation are good references. The conditions regarding utilization of pre-amalgamation losses are not straight forward. Taxpayers are recommended to seek advice from professional tax advisers and consider applying for an advance ruling before proceeding with an amalgamation.

[1] *Hong Kong Tax Newsflash Issue 138*, *Hong Kong Tax Analysis Issue H103/2021* and *Hong Kong Tax Newsflash Issue 141*

[2] Only loss incurred after the amalgamating company and the amalgamated company entered into a qualifying relationship (i.e. one is a wholly owned subsidiary or both are wholly owned by a body corporate) can be used to set off against the assessable profits of the amalgamated company.

[3] The Commissioner of Inland Revenue (CIR) is satisfied that there are good commercial reasons for carrying out the amalgamation.

[4] The amalgamated company continues to carry on a trade or business since the qualifying loss was incurred up to the date of amalgamation.

[5] https://www.ird.gov.hk/eng/tax/bus_cfa.htm

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