

Tax

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Hong Kong Tax Analysis

IRD revises guidance on advance rulings

The Inland Revenue Department (IRD) released the updated guidance on advance rulings, [Department Interpretation and Practice Notes \(DIPN\) No. 31 \(Revised\)](#) (Revised DIPN 31), in April 2020. It replaces the previous version issued in November 2011.

Revised DIPN 31 mainly reflects the requirement to exchange rulings as set out in the *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 - 2015 Final Report* (BEPS Action 5 Final Report) published by the Organisation for Economic Co-operation and Development (OECD) and the legislative changes made by the Inland Revenue (Amendment) (No. 6) Ordinance 2018 in relation to advance rulings.

Spontaneous exchange of information

Hong Kong is a member of the Inclusive Framework on Base Erosion and Profit Shifting (BEPS) and has committed to implement the minimum standards of the BEPS package. By signing the *Multilateral Convention on Mutual Administrative Assistance in Tax Matters*, Hong Kong is required to undertake the spontaneous exchange of information on specific types of tax rulings according to BEPS Action 5 which is one of the four "minimum standards" of the OECD BEPS package.

Information is exchanged spontaneously when the supplying party, having obtained information which it believes will be of interest to the receiving party, passes on the information without the receiving party having asked for it.

Rulings to be exchanged

Out of the six categories of specific rulings as detailed in BEPS Action 5 Final Report, Hong Kong would only be required to exchange the following four categories of rulings:

- (1) Rulings relating to preferential regimes;
- (2) Unilateral Advance Pricing Arrangements (APAs) or other cross-border unilateral rulings in respect of transfer pricing (TP);
- (3) Permanent establishment (PE) rulings; and
- (4) Related party conduit rulings.

According to BEPS Action 5 Final Report, rulings are defined as "any advice, information or undertaking provided by a tax authority to a specific taxpayer or group of taxpayers concerning their tax situation and on which they are entitled to rely".

Authors:

Hong Kong

Sarah Chan

Tax Partner

Tel: +852 2852 1628

Email: sarahchan@deloitte.com.hk

Doris Chik

Tax Director

Tel: +852 2852 6608

Email: dchik@deloitte.com.hk

Carmen Cheung

Tax Manager

Tel: +852 2740 8660

Email: carmcheung@deloitte.com.hk

The definition of rulings excludes any statement or agreement reached as a result of an audit carried out after a taxpayer has filed its tax return or accounts.

An advance ruling, being broadly a written confirmation of the IRD's view of the application of the Inland Revenue Ordinance (IRO) to a specific transaction or arrangement, which is specific to the applicant will be exchanged under the framework if it falls within the categories as mentioned above.

Revised DIPN 31 does not provide detailed guidelines on each category of rulings to be exchanged. Meanwhile, reference could be made to BEPS Action 5 Final Report.

(1) Rulings relating to preferential regimes – In order for a regime to be considered preferential, it must offer some form of tax preference in comparison with the general principles of taxation in the relevant country. A preference offered by a regime may take a wide range of forms, including a reduction in the tax rate or tax base or preferential terms for the payment or repayment of taxes. Where rulings are given in respect of these regimes, there will be an obligation to spontaneously exchange the information.

(2) Unilateral APAs or other cross-border unilateral rulings in respect of TP - Unilateral APAs are APAs established between a tax administration of one country and a taxpayer in its country. Other cross-border unilateral rulings in respect of TP are advance tax rulings on TP issues that fall short of an APA.

(3) PE rulings - This category covers rulings concerning the existence or absence of a PE or any ruling that provides for how much profit will be attributed to a PE.

(4) Related party conduit rulings - This category includes rulings, covering arrangements involving cross-border flows of funds or income through an entity in the country giving the ruling, whether those funds or income flow to another country directly or indirectly.

Timing

The above mentioned rulings, given on or after 1 April 2016, are required to be exchanged within three months of the date received by a competent authority.

Jurisdictions to be exchanged

Revised DIPN 31 sets out the jurisdictions with which rulings should be exchanged. For example, rulings regarding PE will be exchanged to the residence jurisdictions of the head office / PE, the ultimate parent company and immediate parent company. As an illustration, if the advance ruling covers whether a UK company will create a PE in Hong Kong for certain activities carried out in Hong Kong, such ruling will be exchanged by the IRD to the UK tax authority as well as the tax authorities of the UK company's immediate parent company and ultimate parent company.

Rulings exchanged will be protected under the tax confidentiality provisions in the relevant treaty or convention. The information is only used for specified purposes and only disclosed to specified persons and cannot be forwarded or disclosed to other jurisdictions.

Advance ruling system

The IRD also updated its guidance on the advance ruling system under Revised DIPN 31. Some of the key changes are highlighted below:

Additional information and documents

More information are required / requested to be supplied in advance ruling applications.

Spontaneous exchange of information

Applicants need to complete a five-page Appendix attached to the advance ruling application form ([Form IR1297](#)) if spontaneous exchange of information on the ruling is required. Information requested include the type of ruling requested, information (e.g. TIN, jurisdiction of residence, legal name, address etc.) of the ultimate parent company, immediate parent company, related party involved for preferential regime ruling, head office for PE ruling, related party and beneficial owner involved for related party conduit ruling.

Advance ruling regarding source of profits

Similar to the previous version of DIPN, the IRD sets out the lists of information to be supplied in respect of (i) trading profits from the purchase and sale of goods; (ii) profits from manufacturing of goods; and (iii) commission income in the Appendices of Revised DIPN 31. The additional items that the IRD now requests are the jurisdiction where offshore profits / income are generated, details of the offshore activities and confirmation of whether such offshore profits / income are or will be taxed in that jurisdiction.

Computation of profits regarding use of intellectual property

The IRD adds an Appendix with the list of information to be supplied in respect of the percentage applied for computing the assessable profits from the use of intellectual properties that are deemed taxable under section 15(1)(a), (b) or (ba) of the IRO. For example, copies of agreements, full ownership history of the relevant intellectual property, declaration etc.

Adjusted fees for ruling application

Revised DIPN 31 sets out the adjusted fees for advance ruling applications as amended in 2018. The application fee is HK\$45,000 for a ruling on source of profits and HK\$15,000 for other rulings.

Effects of a ruling

Once a ruling has been issued, whether it is advantageous to the applicant or not, the ruling will not be subject to objection or appeal. Nevertheless, a person's right of objection against an assessment subsequently issued in accordance with the unfavourable ruling is not affected. While this practice remains unchanged, the IRD clarifies in Revised DIPN 31 that the applicant can have the choice of not carrying out the proposed arrangement in the case of an unfavourable ruling. However, if the proposed arrangement is effected, the ruling has to be complied with.

Revised DIPN 31 also specifies that guidelines or pamphlets issued by the IRD, including DIPNs, should not be regarded as rulings because they do not apply to a specific person or a class of persons. In other words, IRD's guidelines or pamphlets are not binding to neither the taxpayers nor the IRD.

Our observation

Revised DIPN 31 specifies that certain categories of rulings are subject to spontaneous exchange of rulings requirement under the BEPS Action 5. One of the categories is rulings relating to preferential regimes. *The Harmful Tax Practices – 2018 Peer Review Reports on the Exchange of Information on Tax Rulings* published by the OECD identified and reviewed five preferential regimes in Hong Kong, including profits tax concessions for (1) corporate treasury centres; (2) professional reinsurers; (3) captive insurers; (4) aircraft lessors and aircraft leasing managers; and (5) profits tax exemptions for ship operators. It appears that "rulings relating to preferential regimes" in Hong Kong will likely cover the above. Nevertheless, BEPS Action 5 Final Report mentioned that the obligation to spontaneously exchange information also applies to any ruling in connection with preferential regimes that have not yet been reviewed. Therefore, it is important for the IRD to clarify that apart from the abovementioned five preferential regimes, whether others such as the fund exemption regime, enhanced deduction for R&D expenditure, etc., would fall within the scope.

Revised DIPN 31 required additional information for advance ruling applications. In particular, details of activities and tax position in foreign jurisdictions are requested for advance ruling that involves offshore profits claim.

When one considers whether to apply for advance rulings, applicants should bear in mind the spontaneous exchange of information requirement and the additional information required to be supplied under Revised DIPN 31. Taxpayers should seek professional advice to assess the impact before applying for advance rulings.

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Beijing

Andrew Zhu

Partner

Tel: +86 10 8520 7508

Fax: +86 10 8518 7326

Email: andzhu@deloitte.com.cn

Chengdu

Frank Tang / Tony Zhang

Partner

Tel: +86 28 6789 8188

Fax: +86 28 6500 5161

Email: ftang@deloitte.com.cn

tonzhang@deloitte.com.cn

Chongqing

Frank Tang / Tony Zhang

Partner

Tel: +86 23 8823 1208 / 1216

Fax: +86 23 8859 9188

Email: ftang@deloitte.com.cn

tonzhang@deloitte.com.cn

Dalian

Bill Bai

Partner

Tel: +86 411 8371 2816

Fax: +86 411 8360 3297

Email: bilbai@deloitte.com.cn

Guangzhou

Victor Li

Partner

Tel: +86 755 3353 8113

Fax: +86 755 8246 3222

Email: vicli@deloitte.com.cn

Hangzhou

Qiang Lu

Partner

Tel: +86 571 2811 1900

Fax: +86 571 2811 1904

Email: qilu@deloitte.com.cn

Harbin

Jihou Xu

Partner

Tel: +86 451 8586 0060

Fax: +86 451 8586 0056

Email: jihxu@deloitte.com.cn

Hong Kong

Victor Li

Partner

Tel: +86 755 3353 8113

Fax: +86 755 8246 3222

Email: vicli@deloitte.com.cn

Jinan

Beth Jiang

Partner

Tel: +86 531 8518 1058

Fax: +86 531 8518 1068

Email: betjiang@deloitte.com.cn

Macau

Raymond Tang

Partner

Tel: +853 2871 2998

Fax: +853 2871 3033

Email: raytang@deloitte.com.hk

Shenzhen

Victor Li

Partner

Tel: +86 755 3353 8113

Fax: +86 755 8246 3222

Email: vicli@deloitte.com.cn

Suzhou

Kelly Guan

Partner

Tel: +86 512 6289 1297

Fax: +86 512 6762 3338

Email: kguan@deloitte.com.cn

Tianjin

Bill Bai

Partner

Tel: +86 411 8371 2816

Fax: +86 411 8360 3297

Email: bilbai@deloitte.com.cn

Wuhan

Gary Zhong

Partner

Tel: +86 27 8526 6618

Fax: +86 27 6885 0745

Email: gzhong@deloitte.com.cn

Xiamen

Victor Li

Partner

Tel: +86 755 3353 8113

Fax: +86 755 8246 3222

Email: vicli@deloitte.com.cn

Nanjing

Rosemary Hu

Partner

Tel: +86 25 5791 6129

Fax: +86 25 8691 8776

Email: roshu@deloitte.com.cn

Shanghai

Maria Liang

Partner

Tel: +86 21 6141 1059

Fax: +86 21 6335 0003

Email: mliang@deloitte.com.cn

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National Tax Technical Centre

Email: ntc@deloitte.com.cn

National Leader

Julie Zhang

Partner

Tel: +86 10 8520 7511

Fax: +86 10 8518 1326

Email: juliezhang@deloitte.com.cn

Northern China

Julie Zhang

Partner

Tel: +86 10 8520 7511

Fax: +86 10 8518 1326

Email: juliezhang@deloitte.com.cn

Eastern China

Kevin Zhu

Partner

Tel: +86 21 6141 1262

Fax: +86 21 6335 0003

Email: kzhu@deloitte.com.cn

Southern China (Hong Kong)

Doris Chik

Director

Tel: +852 2852 6608

Fax: +852 2851 8005

Email: dchik@deloitte.com.hk

Southern China (Mainland/Macau)

German Cheung

Director

Tel: +86 20 2831 1369

Fax: +86 20 3888 0121

Email: gercheung@deloitte.com.cn

Western China

Tony Zhang

Partner

Tel: +86 23 8823 1216

Fax: +86 23 8859 9188

Email: tonzhang@deloitte.com.cn

If you prefer to receive future issues by soft copy or update us with your new correspondence details, please notify Wandy Luk by either email at wanluk@deloitte.com.hk or by fax to +852 2541 1911.



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