



# HONG KONG TAX ALERT

January 2021 | Issue 1

## Proposed changes to tax treatment of amalgamations and filing of returns

### Summary



On 4 January 2021, the Legislative Council Panel on Financial Affairs released its discussion paper on the proposed amendments to the taxation of amalgamation of companies and filing of electronic tax returns. Particularly, special tax treatments for qualifying court-free amalgamations and a new rule on the transfer of specified assets without sale have been proposed.

### Overview

The government's proposals on changes to the taxation of amalgamations have been presented to the Legislative Council Panel on Financial Affairs along with proposals to increase the electronic filing of tax returns. Draft legislation of the proposed measures is expected to be introduced in March or April of this year.

### Amalgamations

Since the introduction of simplified procedures for company amalgamations in the revised Companies Ordinance in 2014, the tax consequences of amalgamations have been an area of controversy. A view held by many, and which had been applied in a number of amalgamations prior to the new ordinance, is that an amalgamation takes place through universal succession, such that the surviving entity inherits all the historic attributes of the amalgamating entity, including its tax positions. This would mean that capital allowances, losses and other tax attributes of both companies would be available for use in the continuing entity.

The IRD has taken a different view, which it has published as guidance on its website. It has argued that the amalgamating company ceases to exist on the day immediately before the amalgamation, resulting in a realization of trading stock at open market value. Although it has allowed the succeeding entity to continue to claim capital allowances, it has argued that the amalgamating entity's losses cannot be used by the succeeding entity and imposed restrictions on the use of the pre-amalgamation losses of the succeeding entity.

In this context, it is good that Hong Kong is finally introducing legislation to provide some clarity to taxpayers. Not surprisingly, the legislation is broadly consistent with the non-legislative framework previously set out by the IRD, and will allow amalgamating companies in a qualifying amalgamation to make an election for continuity of tax treatment pre- and post-amalgamation. This would include the losses of both entities, although there will be restrictions and anti-avoidance clauses such that losses will only be available to the extent they arose while both companies were in the same 100% group, where the companies conduct the same trade and the amalgamated company has sufficient financial resources. In its application of its guidance to date the IRD has taken a very narrow view of what constitutes the same trade, and this may be an argument that continues after the introduction of the new law.

The bill will introduce a new rule that where specified assets are transferred without a sale, other than as part of a qualifying amalgamation or as a result of a person's death, they will be deemed to be disposed of at market value for tax purposes.

One important point to note here is that the paper suggests a qualifying amalgamation will be one conducted under Division 3 of Part 13 of the Companies Ordinance. It is not therefore clear whether foreign companies conducting business in Hong Kong will qualify for the amalgamation provisions or whether any such amalgamations would automatically be caught by the deeming provisions.

Further details will be provided in the bill. While most jurisdictions have anti-avoidance provisions to address the artificial transfer of losses (and Hong Kong already has section 61A), it is important that the process is flexible enough that taxpayers can undertake commercially driven mergers without undue tax cost and that the law is administered in this spirit.

## Filing of tax returns

The other principal focus of the paper is a push to increase the number of tax returns filed electronically. This is to be welcomed and many find it surprising that a leading financial centre is still so focused on paper filings so far into the 21st century. The paper announces that electronic filing will be optional and that Legislative Council will be consulted prior to any decision to make it compulsory.

The IRD is also proposing to allow service providers to file returns on behalf of taxpayers and to introduce a range of penalties for service providers who fail to meet their obligations in this regard. These appear to be in addition to any penalties for the taxpayer.

# Contact us



**Lewis Y. Lu**  
National Head of Tax  
Tel: +86 21 2212 3421  
lewis.lu@kpmg.com



**John Timpany**  
Head of Tax, Hong Kong  
Tel: +852 2143 8790  
john.timpany@kpmg.com



**Ivor Morris**  
Partner  
Tel: +852 2847 5092  
ivor.morris@kpmg.com



Hong Kong Tax Alert

[kpmg.com/cn](https://kpmg.com/cn)

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2021 KPMG Huazhen LLP, a People's Republic of China partnership, KPMG Advisory (China) Limited, a limited liability company in China, KPMG, a Macau partnership and KPMG, a Hong Kong partnership, are member firms of the KPMG global organisation of independent member firms affiliated with KPMG International Limited ("KPMG International"), a private English company limited by guarantee. All rights reserved.

© 2021 KPMG Tax Services Limited, a Hong Kong limited liability company and a member firm of the KPMG global organisation of independent member firms affiliated with KPMG International Limited ("KPMG International"), a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.