Inland Revenue Department
The Government of the Hong Kong Special Administrative Region
of the People's Republic of China

DEPARTMENTAL INTERPRETATION AND PRACTICE NOTES

NO. 63

PART A: QUALIFYING AMALGAMATION OF COMPANIES

PART B: TRANSFER OR SUCCESSION OF SPECIFIED ASSETS WITHOUT SALE

These notes are issued for the information of taxpayers and their tax representatives. They contain the Department's interpretation and practices in relation to the law as it stood at the date of publication. Taxpayers are reminded that their right of objection against the assessment and their right of appeal to the Commissioner, the Board of Review or the Court are not affected by the application of these notes.

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Commissioner of Inland Revenue

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PART A: QUALIFYING AMALGAMATION OF COMPANIES

INTRODUCTION

Court-free amalgamation of companies

Amalgamation is a legal process by which the undertaking, property and liabilities of two or more companies merge and are brought under one of the original companies or a newly formed company and their shareholders become the shareholders of the new or amalgamated company.

2. Before the Companies Ordinance (Cap. 622) (CO) came into operation on 3 March 2014, amalgamations could only be done through court-sanctioned statutory procedure under the old Companies Ordinance (Cap. 32) or by way of specific private merger ordinances. The former was rare due to the complex procedures involved, high compliance costs and the court's restrictive approach. The latter only applied to the merger of authorized institutions (i.e., banks).

3. Since 3 March 2014, Division 3 of Part 13 of the CO has provided for a court-free statutory amalgamation procedure for wholly owned intra-group companies incorporated in Hong Kong and limited by shares to amalgamate and continue under one of the amalgamating companies. The amalgamation may take the form of—

(a) a vertical amalgamation between a holding company and one or more of its wholly owned subsidiaries with the holding company as the continuing company (section 680 of the CO); or

(b) a horizontal amalgamation between two or more of the wholly owned subsidiaries of a body corporate with one of them as the continuing company (section 681 of the CO).

4. Under the CO, on the effective date of a court-free amalgamation, each amalgamating company ceases to exist as an entity separate from the amalgamated company, and the amalgamated company succeeds to all the property, rights and privileges, and all the liabilities and obligations, of each amalgamating company in accordance with section 685(3) of the CO.

Tax treatment before 11 June 2021

5. Before the enactment of the Inland Revenue (Amendment) (Miscellaneous Provisions) Ordinance 2021 (Miscellaneous Provisions Ordinance), there was no specific provision in the Inland Revenue Ordinance (IRO)[1] to deal with court-free amalgamations. As an interim measure, the Department published an administrative assessment practice in its website setting out the tax treatment of court-free amalgamations (Appendix 1). The assessor then made assessments on these cases in accordance with the interim administrative assessment practice.

Tax treatment on or after 11 June 2021

6. The Miscellaneous Provisions Ordinance provides for special tax treatments, specified in Schedule 17J, in relation to qualifying amalgamations upon election. The special tax treatments are largely the same as those provided in the interim administrative assessment practice and are applicable to qualifying amalgamations carried out on or after 11 June 2021. For court-free amalgamations carried out before 11 June 2021, Schedule 17J is not applicable and assessments should be made in accordance with the interim administrative assessment practice as mentioned in paragraph 5.

INLAND REVENUE (AMENDMENT) (MISCELLANEOUS PROVISIONS) ORDINANCE 2021

Main provisions

7. The main provisions enacted by the Miscellaneous Provisions Ordinance in relation to qualifying amalgamation are as follows—

(a) A new Part 6C contains general provisions (i.e., sections 40AE to 40AM) relating to qualifying amalgamations.

[1] References to provisions in the following paragraphs are to the IRO unless specified otherwise.

(b) Section 40AE contains definitions of amalgamated company, amalgamating company, qualifying amalgamation, year of cessation, etc.

(c) Section 40AF provides for the application of Part 6C to a qualifying amalgamation that takes effect on or after the date of commencement of the Miscellaneous Provisions Ordinance (i.e., 11 June 2021).

(d) Section 40AG sets out when an amalgamating company is to be treated as having ceased to carry on its trade, profession or business.

(e) Sections 40AH and 40AI enable an assessor to estimate the amount of provisional profits tax payable by an amalgamating company or the amalgamated company for certain years of assessment.

(f) Section 40AJ requires the amalgamated company to comply with all obligations, and meet all liabilities, of each of the amalgamating companies under the IRO.

(g) Section 40AK provides for the amalgamated company's entitlement to all rights, powers and privileges of each of the amalgamating companies under the IRO.

(h) Section 40AL requires the amalgamated company to furnish a return for profits tax for each of the amalgamating companies for its year of cessation.

(i) Section 40AM enables the amalgamated company to elect for the special tax treatments under Schedule 17J to apply to the amalgamated company and each amalgamating company in a qualifying amalgamation.

(j) Schedule 17J provides for special tax treatments for the amalgamating companies and amalgamated company in a qualifying amalgamation.

Definition of terms

Qualifying amalgamation

8. The term "qualifying amalgamation" is defined in section 40AE to mean any amalgamation of companies within a group under section 680 or 681 of the CO for which a certificate of amalgamation has been issued by the Registrar of Companies under section 684(3) of the CO. Section 680 of the CO refers to an amalgamation between a holding company and one or more of its wholly owned subsidiaries (i.e., vertical amalgamation) whereas section 681 of the CO refers to an amalgamation between two or more wholly owned subsidiaries of a body corporate (i.e., horizontal amalgamation). Under the CO, only Hong Kong incorporated companies can be amalgamated under the court-free amalgamation procedure. The body corporate which holds the wholly owned subsidiaries in a horizontal amalgamation could be incorporated outside Hong Kong.

Example 1

Company A1 and Company A2 were incorporated in Hong Kong. They are wholly owned subsidiaries of Company H, a company incorporated in Jurisdiction F. Company A1 and Company A2 amalgamated under section 681 of the CO with Company A2 as the amalgamated company. A certificate of amalgamation had been issued by the Registrar of Companies under section 684(3) of the CO.

The amalgamation between Company A1 and Company A2 was under section 681 of the CO and a certificate of amalgamation had been issued under section 684(3) of the CO. The amalgamation is a qualifying amalgamation within the meaning of section 40AE.

Example 2

Company B1 and Company B2 were incorporated in Hong Kong. They are wholly owned subsidiaries of Company H, a company incorporated in Jurisdiction F. Pursuant to the laws of Jurisdiction F, Company H, Company B1 and Company B2 amalgamated.

The amalgamation among Company H, Company B1 and Company B2 was not under section 680 or 681 of the CO. The amalgamation is NOT a qualifying amalgamation within the meaning of section 40AE.

Amalgamated company

9. The term "amalgamated company" is defined to mean any company that amalgamates with other company or companies in a qualifying amalgamation and the shares of which are not cancelled on the amalgamation. In a qualifying amalgamation, there is only one amalgamated company.

(a) In the case of a vertical amalgamation where a holding company amalgamates with one or more of its wholly owned subsidiaries, the shares of each of the wholly owned subsidiaries will be cancelled on the amalgamation. Therefore, the holding company will be the amalgamated company.

(b) In the case of a horizontal amalgamation where two or more wholly owned subsidiaries of a body corporate amalgamate, the shares of all but one of the subsidiaries will be cancelled on the amalgamation. The subsidiary the shares of which are not cancelled will be the amalgamated company.

Amalgamating company

10. The term "amalgamating company" is defined to mean any company that is amalgamated in a qualifying amalgamation and the shares of which are cancelled on the amalgamation. As mentioned above, except for the amalgamated company, the shares of each of the companies in a qualifying amalgamation will

be cancelled upon the amalgamation. In other words, each of the companies in a qualifying amalgamation other than the amalgamated company is an amalgamating company. Unlike amalgamated company, there may be more than one amalgamating company in an amalgamation.

Application of Part 6C

11. Section 40AF provides that Part 6C applies in relation to a qualifying amalgamation that takes effect on or after 11 June 2021. It should be noted that the general provisions under sections 40AE to 40AL apply to all qualifying amalgamations, whether or not an election for special tax treatments under Schedule 17J has been or would be made in accordance with section 40AM.

Amalgamating company treated as having ceased to carry on business

12. Section 40AG provides that an amalgamating company in a qualifying amalgamation is treated as having ceased to carry on its trade, profession or business on the day immediately before the date of amalgamation. By virtue of section 51(6), the amalgamated company has to inform the Commissioner in writing within one month of the cessation of the amalgamating company. However, if the amalgamated company has given a notice to the Commissioner under section 40AM (i.e., election for the special tax treatments under Schedule 17J, see paragraph 17) within 1 month after the date of amalgamation, no separate notice under section 51(6) is required.

Ascertainment of provisional tax

13. According to section 63H(1), calculation of provisional profits tax in respect of any year of assessment is based on the amount of assessable profits for the year preceding the year of assessment.

14. For an amalgamating company which is treated as having ceased to carry on its trade, profession or business, as the basis period for its year of cessation may be less or more than 12 months, it may not be appropriate to estimate the provisional tax based on the assessable profits for the preceding year of assessment. Section 40AH provides that an assessor may estimate the amount of provisional

profits tax payable by the amalgamating company for the year of cessation, instead of adopting the preceding year basis as provided for in section 63H(1).

15. Similarly, where an amalgamated company succeeds to the trade, profession or business of an amalgamating company on the date of amalgamation, the preceding year basis under section 63H(1) may not be an appropriate basis for calculating the provisional profits tax for the year of assessment the basis period for which the date of amalgamation falls in (the year of amalgamation) and the succeeding year of assessment. Section 40AI provides that an assessor may estimate the amount of provisional profits tax payable by the amalgamated company for the year of amalgamation and the succeeding year of assessment, instead of adopting the preceding year basis as provided for in section 63H(1).

Rights and obligations of amalgamating company

16. Section 40AJ provides that the amalgamated company must comply with all obligations, and meet all liabilities, of each of the amalgamating companies under the IRO, for the year of cessation of the amalgamating companies and all preceding years of assessment. This includes the filing of tax returns, paying outstanding tax liabilities and maintaining business records for the amalgamating company, etc. On the other hand, section 40AK provides that the amalgamated company is entitled to all rights, powers and privileges of each of the amalgamating companies under the IRO for the year of cessation of the amalgamating companies and all preceding years of assessment. In this regard, the amalgamated company could lodge an objection or appeal to assessment for the amalgamating company and would be entitled to a refund of overpayment of tax made by the amalgamating company.

Election for special tax treatments under Schedule 17J

17. While Schedule 17J provides for special tax treatments for qualifying amalgamations, the schedule only applies upon election. Section 40AM(1) provides that the amalgamated company in a qualifying amalgamation may, within 1 month after the date of amalgamation or such further period as the Commissioner may allow, elect for Schedule 17J to apply to it and each amalgamating company in the qualifying amalgamation. The election must be made in writing and once made, it is irrevocable.

18. If an election for special tax treatments is made, any succession of the trade, profession or business, or assets and liabilities of the amalgamating company by the amalgamated company will be treated in accordance with the special tax treatments provided in Schedule 17J. Otherwise, tax assessment will be made in accordance with the relevant provisions in the IRO and in particular—

(a) any unabsorbed loss of the amalgamating company will lapse on the amalgamation and cannot be used to set off against the assessable profits of the amalgamated company;

(b) section 15C will apply to the amalgamating company where its trading stock will be valued at the open market value on the date of cessation of business, for the purposes of computing the amalgamating company's assessable profits for the year of cessation; and

(c) any succession of specified assets (as defined in section 40AO and discussed in paragraph 77 below) will be treated in accordance with Part 6D where each specified asset will be deemed to have been sold by the amalgamating company at a deemed selling price and purchased by the amalgamated company at the same price.

19. In general, the election for special tax treatments under Schedule 17J should be made within 1 month after the date of amalgamation. The Commissioner may consider allowing a further period for making the election if there are justifiable reasons. Examples of justifiable reasons include the sickness of the amalgamated company's principal officer who acts on behalf of the company, the amalgamated company's principal officer being subject to quarantine, and other uncontrollable reason such as fire, flood or other accident, etc. which prevents the amalgamated company from making the election within the specified time limit.

SPECIAL TAX TREATMENTS UNDER SCHEDULE 17J

Overview

20. Schedule 17J provides for special tax treatments in relation to a qualifying amalgamation that takes effect on or after 11 June 2021. The special

tax treatments apply only if an election has been made under section 40AM(1). The special tax treatments mainly concern the following—

(a) succession of the amalgamated company to the following things, rights or interests of an amalgamating company on the amalgamation—

(i) any trade, profession or business carried on by the amalgamating company in Hong Kong, or any trading stock of a trade or business carried on by the amalgamating company in Hong Kong;

(ii) any machinery or plant used for, or any rights or entitlement to any rights generated from, research and development (R&D) activities (as defined by section 2 of Schedule 45);

(iii) any patent rights or rights to any know-how (as defined by section 16E(4));

(iv) any specified intellectual property rights (as defined by section 16EA(11));

(v) interest in any renovation or refurbishment of a building or structure (as defined by section 16F(5));

(vi) any prescribed fixed assets (as defined by section 16G(6));

(vii) any environmental protection facilities (as defined by section 16H(1));

(viii) interest in any commercial or industrial building or structure (as defined by section 40(1));

(ix) any machinery or plant not related to R&D activities;

(b) reclassification of assets from revenue account to capital account and vice versa on the amalgamation;

(c) the deduction (or balance of deduction) for the following items—

(i) any special payment to a recognized retirement scheme made by an amalgamating company before the amalgamation;

(ii) any amount of bad debts or impairment losses in respect of any debts to which the amalgamated company succeeds from an amalgamating company on the amalgamation; and

(iii) any expenditure or losses incurred by the amalgamated company as a result of an act, or a failure to act, of an amalgamating company on the amalgamation;

(d) the treatment of pre-amalgamation losses of an amalgamating company or the amalgamated company;

(e) an irrevocable election made by an amalgamating company under certain provisions of the IRO before the amalgamation;

(f) the income accrued to, or derived by, the amalgamated company as a result of a certain thing that an amalgamating company did, or did not do, before the amalgamation; and

(g) the refund of any contribution or voluntary contribution to an approved retirement scheme made by an amalgamating company that is received by, or accrued to, the amalgamated company on or after the amalgamation.

The special tax treatments provided in Schedule 17J are discussed in the following paragraphs and are summarized in Appendix 2.

Succession of business and assets

21. In general, the amalgamated company is treated as if it were a continuation of an amalgamating company. Section 3(1) of Schedule 17J provides that unless the Commissioner is notified otherwise, the trade, profession or business carried on by an amalgamating company in Hong Kong immediately before the date of amalgamation is treated as being carried on by the amalgamated company in Hong Kong beginning on the date of amalgamation.

22. Pursuant to section 685(3) of the CO, the amalgamated company succeeds to all the assets of each amalgamating company. Section 3(2) of Schedule 17J provides that for each of such assets, unless there is reclassification of the asset, any asset on revenue account of the amalgamating company is treated as an asset on revenue account of the amalgamated company; and any asset on capital account of the amalgamating company is treated as an asset on capital account of the amalgamated company. Section 3(3) further provides that the amalgamated company is treated as—

(a) having acquired the asset on the date on which the amalgamating company acquired it for an amount that was incurred by the amalgamating company in respect of that asset; and

(b) having been charged to tax on all such profits, or allowed all such deductions, in connection with the asset as charged on, or allowed to, the amalgamating company.

23. In general, any balance of allowances or deductions allowable under Part 4 or Part 6 of the IRO in respect of such assets could continue to be claimed by the amalgamated company subject to the satisfaction of specified 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. Details of the relevant tax treatments are discussed in paragraphs 33 to 50.

Reclassification of asset upon amalgamation

From revenue account to capital account

24. Where on amalgamation, any asset on revenue account of an amalgamating company becomes an asset on capital account of the amalgamated company, section 4 of Schedule 17J deems the amalgamating company to have sold the asset to the amalgamated company immediately before the amalgamation for a consideration equal to the amount which the asset would have been realized if it had been sold in the open market on the date of amalgamation. Any profit arising from the deemed sale is to be brought into account for the purposes of computing the chargeable profits of the amalgamating company for the year of cessation. On the other hand, the amalgamated company is deemed to have acquired the relevant asset at the same market value.

From capital account to revenue account

25. Where on amalgamation, any asset on capital account of an amalgamating company becomes an asset on revenue account of the amalgamated company, section 5 of Schedule 17J deems the cost of the asset to the amalgamated company to be equal to the amount that the amalgamated company would have incurred if the asset had been purchased in the open market on the date of amalgamation. In other words, the amount would be taken as the amalgamated company's cost in computing its chargeable profits on subsequent sale of the asset. On the other hand, the amalgamating company is deemed to have sold the asset to the amalgamated company at the same market value which will be chargeable to profits tax (subject to the amount of deduction previously allowed) or used to compute the balancing charge or allowance.

Succession of trading stock

Used as trading stock by the amalgamated company

26. According to section 15C(b), on cessation of business, the trading stock of a person should be valued at the open market price on the date of cessation of business for the purposes of computing the person's chargeable profits for the year of cessation if the trading stock is not transferred at valuable consideration on the date of cessation of business. In other words, the person is

treated as having realized its trading stock in the open market. Given that the amalgamating company is treated as having ceased business on the day immediately before the date of amalgamation and its trading stock is succeeded by the amalgamated company without consideration, the amalgamating company should be treated as having realized the trading stock in the open market by virtue of section 15C(b). However, section 6(2) of Schedule 17J specifically provides that section 15C(b) will not apply if the amalgamated company uses the trading stock as its trading stock for carrying on a trade or business in Hong Kong. In this regard, special tax treatments are provided in sections 6 and 7 of Schedule 17J which are explained in paragraphs 27 to 30.

Amalgamation accounted for using merger method

27. Section 6(3) of Schedule 17J provides that if the trading stock is accounted for in the financial account of the amalgamated company at a value equal to the carrying amount of the trading stock of the amalgamating company immediately before the date of amalgamation, the amalgamated company is deemed to have purchased the trading stock on the amalgamation for a consideration equal to that value.

28. Court-free amalgamation under the CO is available to wholly owned group companies only and therefore, qualifying amalgamations should generally be recorded as business combinations under common control. The merger method in Accounting Guideline 5: *Merger Accounting for Common Control Combinations* instead of the acquisition method in Hong Kong Financial Reporting Standard (HKFRS) 3: *Business Combinations* should be adopted to account for the business combination. In normal cases where the merger method is adopted, the trading stock will be accounted for in the amalgamated company's financial account at its carrying amount. In such circumstances, section 6(3) of Schedule 17J applies and the trading stock will be deemed as being acquired by the amalgamated company at the carrying amount of the trading stock.

29. There is no deemed sale of the trading stock by the amalgamating company and thus, there would not be any realized gain or loss for the amalgamating company arising from the amalgamation. Section 6(4) of Schedule 17J further provides that any unrealized gain or loss in respect of the trading stock

that has not been brought into account in ascertaining the chargeable profits of the amalgamating company—

(a) is treated as an unrealized gain or loss of the amalgamated company in respect of the trading stock; and

(b) is to be brought into account in ascertaining the amalgamated company's chargeable profits when it is realized; or in accordance with the tax treatment applicable to the amalgamated company.

Example 3

On 1 December 2020, Company C1 acquired some shares issued by another company at $10,000 for trading. The fair value of the shares was as follows:

At 1 December 2020	*$10,000*
At 31 December 2020	*$13,000*
At 1 July 2021	*$11,000*

Company C1 recognized and measured the shares in accordance with HKFRS 9. Company C1 elected for assessment on the fair value basis.

On 1 July 2021, Company C1 and Company C2 amalgamated under section 681 of the CO with Company C2 as the amalgamated company. Company C2 succeeded to the shares and used them for trading as well. Merger method was adopted to account for the amalgamation.

The shares were subsequently sold by Company C2 on 31 August 2021 for $12,000. Company C1 and Company C2 closed their accounts on 31 December each year.

Since Company C1 had made an election for assessment on the fair value basis, its assessable profits in respect of the shares would be computed on the fair value basis. Therefore, the gain in fair value changes of $3,000 recognized in profit or loss for the year ended 31 December 2020 should have been chargeable to tax for the year of

assessment 2020/21.

As the merger method was adopted, the shares were accounted for in the financial account of Company C2 at $13,000 (i.e., the carrying amount of the shares) on the date of amalgamation.

For Company C1, section 15C does not apply as Company C2 used the shares as its trading stock. As there is no deemed sale of the shares by Company C1, no gain or loss would be charged on or allowed to Company C1 in respect of the shares for the year of assessment 2021/22 (i.e., its year of cessation).

For Company C2, it would be deemed to have purchased the shares at $13,000. Upon the subsequent sale of the shares, Company C2 would be allowed deduction of the loss of $1,000 (i.e., $13,000 - $12,000) for the year of assessment 2021/22.

Example 4

The facts are the same as Example 3 above but Company C1 did not elect for assessment on the fair value basis.

Since Company C1 did not elect for assessment on the fair value basis, the gain in fair value changes of $3,000, though recognized in profit or loss for the year ended 31 December 2020, was not chargeable to tax for the year of assessment 2020/21. In other words, there was an unrealized gain of $3,000 that had not been brought into account in ascertaining the chargeable profits of Company C1.

As the merger method was adopted, the shares were accounted for in the financial account of Company C2 at $13,000 (i.e., the carrying amount of the shares) on the date of amalgamation.

For Company C1, section 15C does not apply as Company C2 used the shares as its trading stock. As there is no deemed sale of the shares by Company C1, no gain or loss would be charged on or allowed to Company C1 in respect of the shares for the year of assessment 2021/22

(i.e., its year of cessation). By virtue of section 6(4) of Schedule 17J, the unrealized gain of $3,000 would be treated as an unrealized gain of Company C2 in respect of the trading stock.

For Company C2, it would be deemed to have purchased the shares at $13,000 and have an unrealized gain of $3,000 in respect of the shares. Upon the subsequent sale of the shares, Company C2 incurred a loss of $1,000 (i.e., $13,000 - $12,000). On the other hand, the unrealized gain of $3,000 became realized and would be brought into account in computing Company C2's chargeable profits. As such, Company C2 would be charged on the net gain of $2,000 ($3,000 - $1,000) for the year of assessment 2021/22.

Amalgamation accounted for using acquisition method

30. Where the trading stock is accounted for in the financial account of the amalgamated company at a value different from the carrying amount of the trading stock (i.e., the amalgamation is accounted for in the financial account of the amalgamated company by applying the acquisition method), section 7(2) and (3) of Schedule 17J provides that the amalgamating company is deemed to have sold the trading stock to the amalgamated company, and the amalgamated company is deemed to have purchased the trading stock from the amalgamating company, immediately before the date of amalgamation for a consideration equal to the value as reflected in the financial account of the amalgamated company on the date of amalgamation. Section 7(4) of Schedule 17J further provides that any profit arising from the deemed sale is to be brought into account for the purpose of computing the chargeable profits of the amalgamating company for its year of cessation.

Example 5

The facts are the same as Example 3 above but acquisition method was adopted to account for the amalgamation.

Since Company C1 had made election for assessment on the fair value basis, its assessable profits in respect of the shares would be computed on the fair value basis. Therefore, the gain in fair value changes of

$3,000 recognized in profit or loss for the year ended 31 December 2020 should have been chargeable to tax for the year of assessment 2020/21.

As the acquisition method was adopted, the shares were accounted for in the financial account of Company C2 at $11,000 (i.e., the fair value at the date of amalgamation).

Company C1 would be deemed to have sold the shares at $11,000 and the loss of $2,000 (i.e., $13,000 - $11,000) arising from the deemed sale would be brought into account in computing the chargeable profits of Company C1 for the year of assessment 2021/22.

Company C2 would be deemed to have purchased the shares at $11,000. Upon the subsequent sale of the shares, Company C2 would be charged on the gain of $1,000 (i.e., $12,000 - $11,000) for the year of assessment 2021/22.

Not used as trading stock by the amalgamated company

31. Section 8 of Schedule 17J provides that if the amalgamated company does not use the relevant stock as its trading stock for carrying on a trade or business in Hong Kong, section 15C applies to the amalgamating company. In such circumstances, the trading stock is to be valued in accordance with section 15C(b) (i.e., at market value on the date of cessation of business) for the purpose of computing the assessable profits of the amalgamating company for its year of cessation. On the other hand, the amalgamated company is deemed to have purchased the stock at the same market value.

Effect of cancellation of shares of amalgamating company

32. In a qualifying amalgamation, all the shares of each of the amalgamating companies will be cancelled. As such, if an amalgamating company (***first company***) holds shares of another amalgamating company (***second company***), such shares will be cancelled on the amalgamation. In this regard, section 9 of Schedule 17J deems the first company to have sold the shares of the second company immediately before the amalgamation for an amount equal to the

cost of the shares to the first company. It further provides that if the first company has borrowed money to acquire shares of the second company; and the liability arising from the money borrowed is transferred to and becomes the liability of the amalgamated company, no deduction is to be allowed for any interest or other borrowing costs incurred by the amalgamated company on or after the date of amalgamation on such liability unless the shares in the second company are held by the first company on revenue account and the interest or other borrowing costs are incurred in the production of chargeable profits of the amalgamated company.

Example 6

In the year of assessment 2018/19, Company D1, a wholly owned subsidiary of Company H, acquired all the issued shares of Company D2 at a consideration of $10 million for long term investment purpose. To finance the acquisition, Company D1 obtained a loan of $8 million from Bank A. On 1 July 2021, Company H, Company D1 and Company D2 amalgamated under section 680 of the CO. Company H succeeded to the liabilities of Company D1 and became liable to the outstanding loan from Bank A after the amalgamation.

Upon the amalgamation, the shares of Company D1 and Company D2 would be cancelled. The liabilities of Company D1 including the loan from Bank A would be taken over by Company H. However, as the shares of Company D2 were held by Company D1 on capital account, Company H would not be allowed deduction of any interest expenses payable to Bank A after the amalgamation.

Succession of capital assets

Deductions and allowances

33. Parts 4 and 6 of the IRO provide for deductions and allowances in respect of expenditures incurred by a person on the provision of certain capital assets. Upon the election for special tax treatments under Schedule 17J, the amalgamated company will generally be treated as if it were the continuation of and the same person as the amalgamating company. If the amalgamating company had incurred capital expenditures on the provision of such assets, any balance of

allowances or deductions allowable in respect of such assets could continue to be claimed by the amalgamated company. For the year of cessation of the amalgamating company, if the amalgamating company is eligible to claim a deduction or allowance in respect of the capital expenditure incurred on an asset, no deduction or allowance is to be made or allowed to the amalgamated company in respect of the same capital expenditure for the same year of assessment. On subsequent disposal of the relevant assets by the amalgamated company or occurrence of a specified event (as defined by section 40AP), deductions allowed or allowances made to both the amalgamated company and the amalgamating company in respect of the same capital expenditure will be taken into account in determining the amount to be charged on or allowed to the amalgamated company.

Machinery or plant used for, or rights generated from, R&D activities

34. Section 16B provides for the deduction of expenditures for R&D activities. The deduction is allowable for the year of assessment in the basis period for which the expenditure is incurred. On disposal of the relevant assets, section 16B(5) provides that the proceeds of sale of any plant or machinery for, and rights generated from, R&D activities are to be treated as a trading receipt in accordance with Schedule 45.

35. On amalgamation, if the amalgamated company succeeds to any plant or machinery used for, or any rights or entitlement to any rights generated from, R&D activities of an amalgamating company and a deduction for the related R&D expenditure has been allowed to the amalgamating company, section 10 of Schedule 17J provides that section 16B(5) does not apply to the amalgamating company because of the succession. In other words, the amalgamating company would not be deemed to have any trading receipt in this regard.

36. As any allowable deduction in relation to the relevant R&D expenditures would have been fully allowed to the amalgamating company, no further deduction under section 16B will be allowable to the amalgamated company. However, on subsequent disposal of the relevant plant or machinery or rights by the amalgamated company or occurrence of a specified event (as defined by section 40AP), section 16B(5) will apply to the amalgamated company as follows—

(a) the sale proceeds of the plant or machinery or rights will be treated as a trading receipt of the amalgamated company; and

(b) the amount of the trading receipt mentioned in (a) will be restricted to the amount of deduction allowed to the amalgamating company under section 16B for the relevant expenditures.

Example 7

On 1 July 2021, Company E1 and Company E2 amalgamated in accordance with section 681 of the CO and Company E2 became the amalgamated company. Before the amalgamation, Company E1 incurred $100,000 for carrying out R&D activities. Deduction of $300,000 had been allowed to Company E1 under section 16B. On the date of amalgamation, the rights generated from the R&D activities with value of $400,000 were succeeded by Company E2. Company E2 made an election under section 40AM(1). The rights were subsequently sold by Company E2 for $500,000.

As deduction for the expenditure on R&D activities had been allowed to Company E1, on disposal of the rights, an amount of $300,000 (restricted to the amount of deduction allowed to Company E1) would be deemed as a trading receipt of Company E2 for the year of disposal of the rights.

Patent rights or rights to any know-how

37. Section 16E provides for the deduction of capital expenditures incurred on the purchase of patent rights or rights to any know-how. The deduction is allowable for the year of assessment in the basis period for which the expenditure is incurred. Section 16E(3) provides that if the relevant rights are subsequently sold, the relevant proceeds of sale are to be treated as a trading receipt.

38. Similar to the treatment in respect of rights generated from R&D activities, where an amalgamated company succeeds to any patent rights or rights to any know-how of an amalgamating company on the amalgamation and a deduction for the capital expenditure incurred on the purchase of such rights has

been made to the amalgamating company under section 16E(1), no further deduction under section 16E will be allowable to the amalgamated company. Section 11 of Schedule 17J provides that—

(a) section 16E(3) does not apply to the amalgamating company because of the succession (i.e., the amalgamating company would not be deemed to have any trading receipt); and

(b) on subsequent sale of the rights by the amalgamated company or occurrence of a specified event (as defined by section 40AP), section 16E(3) will apply to the amalgamated company such that the sale proceeds of the rights, restricted to the amount of deduction allowed to the amalgamating company, will be treated as a trading receipt of the amalgamated company.

Specified intellectual property rights

39. Section 16EA provides for the deduction of capital expenditures incurred on the purchase of specified intellectual property rights. The deduction is allowable by 5 equal amounts with one for the year of assessment in the basis period for which the specified capital expenditure is incurred; and one for each of the next succeeding 4 years of assessment. If the right is subsequently sold, section 16EB(2) provides that where the sale proceeds exceed the unallowed amount or there is not an unallowed amount, the excess or the sale proceeds (as the case may be) will be treated as a trading receipt. On the contrary, if the unallowed amount exceeds the sale proceeds, the excess will be deducted for the year of sale.

40. Where an amalgamated company succeeds to any specified intellectual property rights of an amalgamating company on the amalgamation, according to section 12 of Schedule 17J—

(a) section 16EB(2) does not apply to the amalgamating company because of the succession (i.e., the amalgamating company would not be deemed to have any trading receipt);

(b) subject to (c), any balance of deduction allowable under section 16EA(2) will be made to the amalgamated company, as would

have fallen to be made to the amalgamating company if the amalgamating company had continued to own the specified intellectual property rights;

(c) if the amalgamating company is eligible to claim a deduction under section 16EA(2) for its year of cessation, no deduction will be allowed to the amalgamated company for the same year of assessment; and

(d) on subsequent sale of the rights by the amalgamated company or occurrence of a specified event (as defined by section 40AP), section 16EB(2) will apply to the amalgamated company. In the case where the sale proceeds exceed the unallowed amount or there is not an unallowed amount, the excess or the sale proceeds (as the case may be) will be treated as a trading receipt of the amalgamated company. In any event, the amount of deemed trading receipt is restricted to the total amount of deductions allowed to the amalgamating company and the amalgamated company.

Example 8

Company F1 was carrying on a business in Hong Kong. On 1 April 2019, Company F1 incurred $1,000,000 for acquiring a registered design for use in its business in Hong Kong. On 1 July 2021, Company F1 and Company F2 amalgamated under section 681 of the CO with Company F2 as the amalgamated company. All of Company F1's assets including the registered design were succeeded by Company F2. Company F1 and Company F2 closed their accounts on 31 March each year.

The capital expenditure of $1,000,000 would be allowable for deduction under section 16EA over five years by equal amounts, starting from the year of assessment 2019/20, as follows—

Year of assessment	Company F1	Company F2
2019/20	200,000	-
2020/21	200,000	-
2021/22	200,000	-
2022/23	-	200,000
2023/24	-	200,000

For the year of assessment 2021/22 (i.e., the year of cessation of Company F1), as Company F1 is eligible to claim the deduction, no deduction would be allowable to Company F2 though Company F2 has succeeded to the registered design during the basis period for the year of assessment 2021/22.

Refurbished buildings or structures

41. Section 16F provides for the deduction of capital expenditures on the renovation or refurbishment of a building or structure. The deduction is allowable by 5 equal amounts with one for the year of assessment in the basis period for which the capital expenditure is incurred; and one for each of the next succeeding 4 years of assessment.

42. Where an amalgamated company succeeds to an amalgamating company's interest in any renovation or refurbishment of a building or structure on the amalgamation and a deduction has been made to the amalgamating company for the capital expenditure incurred on the renovation or refurbishment under section 16F(1), section 13 of Schedule 17J provides that—

(a) subject to (b), any balance of deduction allowable under section 16F(1) will be made to the amalgamated company; and

(b) where the amalgamating company is eligible to claim a deduction under section 16F(1) in respect of the capital expenditure for its year of cessation, no deduction will be made to the amalgamated company for the same year of assessment.

Prescribed fixed assets

43. Section 16G provides for the deduction of specified capital expenditures incurred on the provision of prescribed fixed assets. The deduction is allowable for the year of assessment in which the expenditure is incurred. If the asset is subsequently sold or destroyed, section 16G(3) provides that the sale proceeds or compensation received, restricted to the amount of deduction allowed, will be treated as a trading receipt.

44. Where an amalgamated company succeeds to any prescribed fixed assets of an amalgamating company on the amalgamation and a deduction for the specified capital expenditure incurred on the provision of the assets has been allowed to the amalgamating company under section 16G(1), no further deduction in respect of the prescribed fixed assets will be allowable to the amalgamated company. Section 14 of Schedule 17J provides that—

(a) section 16G(3) does not apply to the amalgamating company because of the succession (i.e., the amalgamating company would not be deemed to have any trading receipt); and

(b) if the assets are subsequently sold by the amalgamated company or destroyed or a specified event (as defined by section 40AP) occurs, section 16G(3) will apply to the amalgamated company such that the sale proceeds or the compensation received, restricted to the amount of deduction allowed to the amalgamating company, will be treated as a trading receipt of the amalgamated company.

Environmental protection facilities

45. Section 16I provides for the deduction of specified capital expenditures incurred in relation to environmental protection facilities. The deduction is allowable for the year of assessment in which the expenditure is incurred. If the relevant asset is subsequently sold, destroyed or stolen, section 16J(2), (2A), (3), (3A), (5), (5A) and (5B) provides that the sale proceeds or compensation received, restricted to the amount of deduction allowed, will be treated as a trading receipt.

46. Where an amalgamated company succeeds to any environmental protection facilities on the amalgamation and a deduction for the specified capital expenditure in relation to the environmental protection facilities has been allowed to the amalgamating company under section 16I, no further deduction in respect of the environmental protection facilities will be allowable to the amalgamated company. Section 15 of Schedule 17J provides that—

(a) section 16J(2), (2A), (3), (3A), (5), (5A) and (5B) does not apply to the amalgamating company because of the succession (i.e., the amalgamating company would not be deemed to have any trading receipt);

(b) if the environment protection facilities are subsequently sold by the amalgamated company, destroyed or stolen, or a specified event (as defined by section 40AP) occurs, section 16J(2), (2A), (3), (3A), (5), (5A) or (5B) (whichever is applicable) will apply to the amalgamated company. The sale proceeds or compensation received in respect of the environmental protection facilities, restricted to the amount of deduction allowed to the amalgamating company, will be treated as a trading receipt of the amalgamated company.

Commercial or industrial buildings or structures

47. Sections 33A and 34 provide for the granting of allowances in respect of capital expenditures incurred in relation to commercial or industrial buildings or structures. For industrial buildings or structures, initial allowance will be made for the year of assessment in which the relevant capital expenditure is incurred. If, when the building or structure first comes to be used, it is not an industrial building or structure, section 34(1)(b) provides that an additional assessment will be raised to withdraw the initial allowance previously granted. If the relevant interest in the building or structure is sold or an event (such as the leasehold interest comes to an end or the building or structure is demolished or destroyed) mentioned in section 35(1)(a) arises, a balancing allowance or balancing charge will be made or charged in accordance with section 35.

48. Where an amalgamated company succeeds to an amalgamating company's relevant interest in any building or structure on the amalgamation, sections 16 and 17 of Schedule 17J provide that—

(a) section 35 does not apply to the amalgamating company because of the succession (i.e., no balancing allowance or balancing charge would be made to or on the amalgamating company);

(b) where any initial allowance has been made to the amalgamating company in relation to the capital expenditure incurred on the construction of the building or structure under section 34(1), and the building or structure has not come to be used before the date of amalgamation—

(i) section 34(1)(b) does not apply to the amalgamating company because of the succession; and

(ii) if, when the building or structure first comes to be used, it is not an industrial building or structure, section 34(1)(b) does not apply in relation to the initial allowances made to the amalgamating company before the amalgamation; instead, a sum equal to the amount of the initial allowance made to the amalgamating company is deemed to be a trading receipt of the amalgamated company and accruing on the date of amalgamation;

(c) no initial allowance is to be made to the amalgamated company because of the succession;

(d) annual allowances are to be made to the amalgamated company as would have fallen to be made to the amalgamating company if the amalgamating company had continued to be entitled to the relevant interest in relation to the capital expenditure incurred on the construction of the building or structure;

(e) if the amalgamating company is eligible to claim an annual allowance for its year of cessation, no annual allowance is to be made to the amalgamated company for the same year of assessment; and

(f) if an event mentioned in section 35(1)(a) arises or a specified event (as defined by section 40AP) occurs after the amalgamation, any balancing allowance or balancing charge under section 35 is to be made to or on the amalgamated company, as would have fallen to be made to or on the amalgamating company if the amalgamating company had continued to be entitled to the relevant interest in relation to the capital expenditure incurred on the construction of the building or structure. The amount of balancing charge, if any, would be restricted to the total amount of allowances made to both the amalgamating company and the amalgamated company.

Example 9

Company G1, carrying on a qualifying trade, incurred $10,000,000 on the construction of an industrial structure in the year of assessment 2019/20. Initial allowance of $2,000,000 was granted to Company G1. On 1 October 2021, before the structure was put into use, Company G1 and Company G2 amalgamated under section 681 of the CO with Company G2 as the amalgamated company. Company G1's business, assets and liabilities were succeeded by Company G2. The structure had not been used until 1 April 2022 and it was then used by Company G2 as a show room. Company G1 and Company G2 closed their accounts on 31 March each year.

Although when the structure was first used, it was not used as an industrial building, no additional assessment for the year of assessment 2019/20 would be raised on Company G1 to disallow the initial allowance of $2,000,000 previously granted to it. Instead, a sum of $2,000,000 (i.e., same amount as the initial allowance

previously granted to Company G1) will be deemed to be a trading receipt of Company G2 for the year of assessment 2021/22 (i.e., deemed to be accruing on 1 October 2021, the date of amalgamation)

Machinery or plant not related to R&D activities

49. Sections 37, 37A and 39B provide for the granting of initial and annual allowances in respect of capital expenditures incurred on the provision of machinery or plant. If an event or situation mentioned in section 38(1) or 39D arises, a balancing allowance or balancing charge will be made or charged in accordance with section 38 or 39D (as the case may be).

50. Where an amalgamated company succeeds to any machinery or plant not related to R&D activities of an amalgamating company on the amalgamation, sections 18 and 19 of Schedule 17J provide that—

(a) sections 38 and 39D do not apply to the amalgamating company because of the succession (i.e., no balancing allowance or balancing charge would be made to or on the amalgamating company);

(b) no initial allowance is to be made to the amalgamated company because of the succession;

(c) the annual allowances are to be made to the amalgamated company as would have fallen to be made to the amalgamating company if the amalgamating company had continued to own the machinery or plant;

(d) if the amalgamating company is eligible to claim an annual allowance for its year of cessation, no annual allowance is to be made to the amalgamated company for the same year of assessment; and

(e) if an event or situation mentioned in section 38(1) or 39D arises or a specified event (as defined by section 40AP) occurs after the amalgamation, any balancing allowance or balancing

charge is to be made to or on the amalgamated company, as would have fallen to be made to or on the amalgamating company if the amalgamating company had continued to own the machinery or plant. The amount of balancing charge, if any, would be restricted to the total amount of allowances made to both the amalgamating company and the amalgamated company.

Pre-amalgamation loss

Meaning of pre-amalgamation loss

51. Pre-amalgamation loss of an amalgamating company refers to its unabsorbed loss incurred before the amalgamation. In general, tax losses are specific to a company and any unabsorbed loss of an amalgamating company will lapse on the amalgamation and cannot be transferred to the amalgamated company. That said, section 24 of Schedule 17J allows certain pre-amalgamation loss of an amalgamating company to be used to set off against the assessable profits of the amalgamated company, subject to the following conditions—

(a) post entry condition (see paragraphs 53 to 55);

(b) same trade condition (see paragraphs 56 to 58); and

(c) Commissioner's satisfaction condition (see paragraphs 63 to 66).

52. Pre-amalgamation loss of the amalgamated company refers to its unabsorbed loss incurred before the amalgamation. Section 25 of Schedule 17J provides that such pre-amalgamation loss cannot be used to set off against the assessable profits of the amalgamated company derived from the business or partnership interest succeeded from the amalgamating company unless all of the following conditions are met—

(a) post entry condition (see paragraphs 53 to 55);

(b) trade continuation condition (see paragraph 59);

(c) financial resources condition (see paragraphs 60 to 62); and

(d) Commissioner's satisfaction condition (see paragraphs 63 to 66).

If not all the conditions are met, the pre-amalgamation loss of the amalgamated company can only be used to set off against the assessable profits derived by the amalgamated company from its other trade or business (i.e., other than that succeeded from the amalgamating company).

Post entry condition

53. To prevent an entity from acquiring an unrelated loss company and making use of the tax losses accumulated in that loss company before the acquisition to reduce the tax liabilities of the group through amalgamation, the post entry condition is imposed in respect of the pre-amalgamation loss of the amalgamating company as well as the pre-amalgamation loss of the amalgamated company.

54. In respect of the pre-amalgamation loss of an amalgamating company, only the part of the loss that was incurred after the amalgamating company and the amalgamated company entered into a qualifying relationship (***qualifying loss***) can be used to set off against the assessable profits of the amalgamated company. In this regard, two companies have a qualifying relationship if one of the companies is a wholly owned subsidiary of the other company; or both companies are wholly owned subsidiaries of a body corporate.

Example 10

Company H1 and Company H2 were both incorporated in Hong Kong. Company H1 and Company H2 became a wholly owned subsidiary of Holding Company on 1 April 2020 and 1 January 2021 respectively. On 1 July 2021, Company H1 and Company H2 amalgamated in accordance with section 681 of the CO with Company H2 as the amalgamated company. Company H1 made losses and had pre-

amalgamation loss of $1,000,000, including $800,000 brought forward from the period before 1 January 2021.

Company H1 and Company H2 entered into a qualifying relationship on 1 January 2021 (i.e., the date on which both Company H1 and Company H2 became wholly owned subsidiaries of Holding Company). The pre-amalgamation loss of $800,000 incurred by Company H1 before 1 January 2021 cannot be used to set off against the assessable profits of Company H2. Provided that the other conditions are satisfied, the qualifying loss of $200,000 sustained by Company H1 on or after 1 January 2021 could be used to set off against the assessable profits of Company H2 derived from the business or partnership interest succeeded from Company H1.

55. Similarly, in respect of the pre-amalgamation loss of an amalgamated company, only the part of the loss that was incurred after the amalgamated company and the amalgamating company entered into a qualifying relationship can be used to set off against the assessable profits of the amalgamated company derived from the business or partnership interest succeeded from the amalgamating company. The pre-amalgamation loss incurred by the amalgamated company before the relevant companies entered into a qualifying relationship can only be used to set off against the assessable profits derived by the amalgamated company from its other trade or business (i.e., other than that succeeded from the amalgamating company).

Same trade condition

56. Commercially, an amalgamation should be the combination of two or more companies into a larger single company to carry on the business of each amalgamating company, but not to close the amalgamating company's business and utilize the amalgamating company's pre-amalgamation loss to set off against the assessable profits of other companies within the group with a view to reducing the tax liability. To avoid the use of qualifying amalgamation as a means for tax avoidance, the same trade condition is imposed.

57. Section 24(4) of Schedule 17J provides that any qualifying loss of an amalgamating company could only be used to set off against—

(a) the assessable profits of the amalgamated company derived from the same trade, profession of business that was carried on by the amalgamating company immediately before the amalgamation and is succeeded by the amalgamated company; or

(b) the amalgamated company's share of assessable profits of a partnership through succession to the amalgamating company's interest in the partnership.

58. According to the judgment of Walton J in *Rolls-Royce Motors Ltd v Bamford* [1976] STC 162, whether two businesses are the same is a matter of fact. In determining whether the business carried on after the amalgamation is the same as that carried on immediately before the amalgamation, all facts, such as the business model, operating style, and registered brand, would be taken into account before reaching a conclusion.

Example 11

Company J1 and Company J2, incorporated in Hong Kong, were wholly owned subsidiaries of Holding Company. Company J1 operated a restaurant located in Central (Restaurant 1), which served Japanese cuisine. Company J2 owned and operated an Italian restaurant in Wanchai. Company J1 made losses. Company J1 and Company J2 amalgamated in accordance with section 681 of the CO and Company J2 became the amalgamated company. 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 same trade test would be accepted as having been met if 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.

Example 12

Company K1 and Company K2, incorporated in Hong Kong, were wholly owned subsidiaries of Holding Company. Company K1 and Company K2 were trading in the same products but with different customer bases. Company K1 was trading with customers in the Greater China Region whereas Company K2 was trading with customers in the ASEAN member countries. Company K2 incurred losses. Company K1 and Company K2 amalgamated in accordance with section 681 of the CO. Company K1 became the amalgamated company.

Since Company K1 and Company K2 sold the same products, the same trade test would be accepted as having been met if there were no significant differences in their mode of operations. Sales to customers in the Greater China Region after the amalgamation would be treated as an expanded part of the business of Company K2 as a result of its organic growth. Any qualifying loss of Company K2 could be used to set off against the assessable profits of Company K1 after the amalgamation.

Example 13

Company L1, a wholly owned subsidiary of Holding Company, was a special purpose vehicle incorporated in Hong Kong for the purpose of acquiring and developing a residential site in Kowloon for sale. Company L2, another wholly owned subsidiary of Holding Company, was a special purpose vehicle incorporated in Hong Kong for the purpose of acquiring and developing a residential site in Kowloon for leasing. Company L1 incurred heavy losses after completing the sale of all the apartment units on the residential blocks constructed on the residential site. Company L1 and Company L2 then amalgamated and Company L2 became the amalgamated company. The amalgamation was carried out in accordance with section 681 of the CO. When the amalgamation was completed, Company L2 constructed a block of

building on the residential site and leased out the units therein for earning rental income.

The same trade test would not be satisfied. The development and holding of a residential building for earning lease rental was a business different from that of deriving selling profits from the construction and sale of residential units. Any qualifying loss of Company L1 on sale of residential apartment units cannot be used to set off against the assessable profits of Company L2 after the amalgamation.

Trade continuation condition

59. The trade continuation condition is imposed in relation to the use of pre-amalgamation loss of the amalgamated company. The purpose is to avoid the use of qualifying amalgamation as a means to utilize the unabsorbed loss of a dormant or inactive company. The trade continuation condition is that—

(a) the amalgamated company has continued to carry on a trade, profession or business since the qualifying loss was incurred up to the date of amalgamation; and

(b) if the qualifying loss was a share of loss incurred in a partnership business, the partnership has continued to carry on a trade, profession or business since the qualifying loss was incurred up to the date of amalgamation.

Financial resources condition

60. The purpose of the financial resources condition is to minimize the risk of achieving group tax loss relief through amalgamation. Whether or not a company has financial ability to acquire the business of the amalgamating company is one of the indicators to infer whether there is an intention for tax avoidance. If the amalgamated company has incurred substantial losses in the past, it is difficult for it to carry out amalgamation with a commercial purpose unless it has sufficient financial resources.

61. The term "financial resources" is broad and may include capital, liquid assets or cash. In applying the financial resources test, it may be necessary to consider the ability of the amalgamated company to raise funds from independent third parties having regard to its own credit rating. However, a loan borrowed from the parent company by a subsidiary company for the purpose of acquiring the business of the amalgamating company would not be treated as the financial resources of the subsidiary company for the purpose of the financial resources test.

62. On the other hand, it is not uncommon for the parent company to grant credit or provide financial assistance to the subsidiary company during day-to-day operations or normal trading transactions between the two companies. Such inter-company transactions would not be regarded as borrowing of money from the parent company by the subsidiary company for the purpose of the financial resources test.

Commissioner's satisfaction condition

63. Sections 24(5) and 26(3) of Schedule 17J provide that unless the Commissioner is satisfied that there are good commercial reasons for carrying out the qualifying amalgamation, and avoidance of tax is not the main purpose or one of the main purposes of carrying out the qualifying amalgamation, no pre-amalgamation loss of the amalgamating company can be used to set off against the assessable profits of the amalgamated company; and no pre-amalgamation loss of the amalgamated company can be used to set off against the assessable profits of the amalgamated company derived from the business or partnership interest succeeded from the amalgamating company.

64. The expression "main purpose or one of the main purposes" is widely used in the IRO and double taxation agreements. The courts in *Marwood Homes Ltd v IRC* [1999] STC (SCD) 44, *Snell v RCC* [2008] STC (SCD) 1094, *Lloyds TSB Equipment Leasing (No. 1) Ltd v RCC* [2014] STC 2770 and *Travel Document Service & Ladbroke Group International v HMRC* [2018] STC 723 confirmed that an arrangement can have more than one main purpose and obtaining a tax advantage can be a main object of an arrangement. In order for a purpose to be "main", it must have a connotation of importance. The reference to "one of the main purposes" means that obtaining tax benefit does not need to be the sole or dominant purpose of a particular arrangement. An arrangement may

have more than one main purpose and it is sufficient that at least one was to obtain the tax benefit, even if that was not the dominant purpose.

65. In determining whether there are good commercial reasons for carrying out the qualifying amalgamation and whether there exists a main purpose for avoidance of tax, all relevant facts and circumstances would be considered, such as the reasons and circumstances for the amalgamation, what result the amalgamation intended to achieve or has achieved, the non-tax purpose of the amalgamation and whether there are alternative ways to achieve the non-tax purpose.

66. If tax benefit is only an incidental consequence of the qualifying amalgamation, the obtaining of tax benefit would not be considered a main purpose. The pre-amalgamation loss would be allowed for the set-off subject to the satisfaction of other conditions. On the other hand, if the tax benefit is achieved through deliberate arrangement, the pre-amalgamation loss would not be allowed for the set-off.

Special payment under recognized retirement scheme

67. Section 16A provides for the deduction of special payment under a recognized retirement scheme. One fifth of the payment is allowable for the year of assessment in which the payment is made and the remaining 4 parts will be allowed for each of the succeeding 4 years of assessment.

68. Section 20 of Schedule 17J provides that where an amalgamating company has made a payment to a recognized retirement scheme in respect of which a deduction has been allowed to the amalgamating company under section 16A, any balance of deduction under section 16A(1) is to be made to the amalgamated company. If the amalgamating company is eligible to claim the deduction for its year of cessation, no deduction is to be made to the amalgamated company for the same year of assessment.

Bad debts, impairment losses, expenditure or losses

69. Section 21 of Schedule 17J provides that where at any time after an amalgamation, the amalgamated company writes off an amount as bad or doubtful

debt, or recognizes an impairment loss in respect of a credit-impaired debt, and the debt was succeeded from an amalgamating company on the amalgamation; or incurs expenditure or loss as a result of an act, or a failure to act, of an amalgamating company on the amalgamation, a deduction for the amount of the debt written off, impairment loss, expenditure or loss is to be allowed to the amalgamated company, if the amalgamating company would have been allowed the deduction but for the amalgamation.

70. Conversely, section 22 of Schedule 17J provides that where at any time after an amalgamation, the amalgamated company recovers any amount of a debt or reverses any impairment loss of a debt that has been deducted under section 16(1)(d) or 18K(3) in ascertaining the assessable profits of an amalgamating company, the amount of the debt recovered or the impairment loss reversed, as the case may be, is treated as a trading receipt of the amalgamated company and accruing on the date of recovery or reversal, if such amount would have been treated as the amalgamating company's chargeable income but for the amalgamation.

Release of debt

71. Where any amount of a debt owed by an amalgamating company in the course of carrying on a trade, profession or business in Hong Kong before the amalgamation is released at any time on or after the amalgamation, section 23 of Schedule 17J provides that the amount so released is deemed to be a trading receipt of the amalgamated company and accruing at the time when the release was effected, if such amount would have been deemed to be the amalgamating company's chargeable income but for the amalgamation.

Income derived after amalgamation

72. Pursuant to section 28 of Schedule 17J, the following sum accrued or derived after the amalgamation is deemed to be a trading receipt of the amalgamated company, if the sum would have been deemed to be the amalgamating company's chargeable income but for the amalgamation—

(a) a sum accrued to or derived by the amalgamated company; or

(b) a sum, which would have been deemed to be an income of an amalgamating company chargeable to profits tax but for the amalgamation, accrued to or derived by a person,

as a result of a certain thing that the amalgamating company did, or did not do, before the amalgamation.

Refund from approved retirement scheme after amalgamation

73. Where in ascertaining the assessable profits of an amalgamating company, there has been allowed deductions in respect of—

(a) contributions paid as an employer to a recognized occupational retirement scheme; or

(b) voluntary contributions paid as an employer to a mandatory provident fund scheme,

section 29 of Schedule 17J provides that any refund of the contributions or voluntary contributions, as the case may be, received by or accrued to, the amalgamated company after the amalgamation is deemed to be a trading receipt of the amalgamated company, if the refund would have been deemed to be the amalgamating company's chargeable income but for the amalgamation.

ADVANCE RULINGS

74. To secure certainty on the issues arising from an amalgamation, the parties involved may consider applying for an advance ruling from the department. When seeking for a ruling, the applicant must disclose and provide all relevant information as specified by the Commissioner. Departmental Interpretation and Practice Notes No. 31: *Advance Rulings* sets out details of the procedures for applying for a tax ruling.

75. The information and documents that may be required to be provided in an application for a ruling about qualifying amalgamation are set out in Appendix 3. In some cases, it may be necessary for the Commissioner to seek further information before a ruling can be given.

PART B: TRANSFER OR SUCCESSION OF SPECIFIED ASSETS WITHOUT SALE

BACKGROUND

76. Except for the provisions dealing with cessation of business without sale of environment-friendly vehicle (section 16J(5B)) and machinery or plant (sections 38(4) and 39D(4)), there had not been specific provisions in the IRO to deal with the transfer of assets without sale before the enactment of the Miscellaneous Provisions Ordinance. In the absence of specific provisions, the capital expenditure which has been allowed deduction or allowance could not be clawed back after the underpinning assets were transferred without sale. The Miscellaneous Provisions Ordinance amended the IRO by introducing specific provisions, that is, sections 40AN to 40AU, under the new Part 6D to deem the transfer of specified assets without sale upon occurrence of certain specified events as a sale. These provisions came into effect on 11 June 2021.

DEFINITION OF TERMS

Specified asset

77. "Specified asset", in relation to a person, is defined in section 40AO to mean any of the following assets, for which a deduction or an allowance for the relevant capital expenditure has been allowed or made to the person—

(a) machinery or plant for, rights or entitlement to any rights generated from, R&D activities (section 16B);

(b) patent rights or rights to any know-how (section 16E);

(c) specified intellectual property rights (section 16EA);

(d) prescribed fixed asset (section 16G);

(e) environmental protection facilities (section 16I);

(f) commercial/industrial building or structure (section 33A or 34); or

(g) machinery or plant (section 37, 37A or 39B).

78. If the specified asset is succeeded by the person from an amalgamating company in a qualifying amalgamation and an election for special tax treatments under Schedule 17J has been made by the person under section 40AM(1), a deduction allowed or an allowance made to the person referred to in paragraph 77 includes a deduction allowed or an allowance made to the amalgamating company.

Specified event

79. According to section 40AP, a specified event is, in relation to any specified asset of a person (***relevant person***)—

(a) the transfer of the specified asset to another person without sale, other than by way of—

(i) succession on the relevant person's death; or

(ii) a qualifying amalgamation; or

(b) the succession to the specified asset by another person through a qualifying amalgamation in relation to which no election has been made under section 40AM(1).

DEEMED SALE AND PURCHASE

80. Section 40AS provides that if a specified event occurs in relation to a person, the person's specified asset is deemed to have been sold for a sum that is the lower of—

(a) the open market value of the asset; and

(b) the capital expenditure incurred by the person; or for an asset in relation to R&D activities, the total amount of deductions allowed under section 16B.

81. Further, section 40AT deems the person to have received the same sum as sale proceeds for the purposes of section 16B(5), 16E(3), 16EB(2), 16G(3), 16J, 35, 38 or 39D, or section 16 or 17 of Schedule 45 (i.e., for the purpose of computing the amount of deductions to be clawed back or the amount of balancing allowance or balancing charge in respect of the specified asset).

82. On the other hand, section 40AU deems the person to whom the specified asset is transferred, or who succeeds to the specified asset, to have incurred the sum as expenditure on the purchase of the specified asset for the purpose of computing the assessable profits of that person.

Example 14

Company M1 was a wholly owned subsidiary of Company M2. On 1 July 2021, Company M1 and Company M2 amalgamated in accordance with section 680 of the CO. Before the amalgamation, Company M1 incurred $1,000,000 for acquiring manufacturing machinery. A deduction of $1,000,000 had been allowed to Company M1 under section 16G. On the date of amalgamation, the market value of the machinery was $200,000. After the amalgamation, Company M2 incurred a further sum of $3,000,000 for acquiring manufacturing machinery. A deduction of $3,000,000 was allowed to Company M2 under section 16G. The machinery was subsequently transferred to Company M3 as a gift. At the date of the transfer, the market value of the machinery was $1,500,000. Company M2 made an election under section 40AM(1).

For Company M1, since an election was made under section 40AM(1), the succession of the machinery by Company M2 from Company M1 would not be deemed as a sale. Accordingly, Company M1 would not be deemed to have received any sale proceeds for the purpose of section 16G(3).

For Company M2, the transfer of the machinery from Company M2 to Company M3 would be deemed to be a sale at the lower of the market value of the machinery (i.e., $1,500,000) or the total amount of deductions allowed to both Company M1 (i.e., $1,000,000) and

Company M2 (i.e., $3,000,000). In this scenario, the deemed selling price would be $1,500,000. Company M2 would be deemed to have received the sale proceeds of $1,500,000 for the purposes of section 16B(5) and the amount would be treated as a trading receipt of Company M2 accordingly.

For Company M3, it would be deemed to have incurred $1,500,000 on the purchase of the machinery.

Example 15

The facts are the same as those in Example 14. However, Company M2 had not made an election under section 40AM(1).

Since no election was made under section 40AM(1), the succession of the machinery by Company M2 from Company M1 would be deemed as a sale. Company M1 would be deemed to have received proceeds from the sale of the machinery in the amount of $200,000 (i.e., the lower of the market value or the amount of deduction allowed to Company M1).

On the other hand, Company M2 would be deemed as having acquired the machinery for a consideration of $200,000.

Upon the transfer of the machinery from Company M2 to Company M3, Company M2 would be deemed to have received proceeds from the sale of the machinery at the lower of the market value of the machinery (i.e., $1,500,000) or the total amount of deductions allowed to Company M2 (i.e., $3,200,000). In this scenario, the deemed sale proceeds would be $1,500,000.

For Company M3, it would be deemed to have incurred $1,500,000 on the purchase of the machinery.

Appendix 1

Administrative Assessment Practice for Court-free Amalgamation carried out before 11 June 2021

Amalgamation with sale of assets of the amalgamating company

1. If the court free amalgamation is structured with a sale of assets on an arm's length basis, the provisions relating to sale of assets will be applied to such amalgamation to assess any deemed trading receipts and to make balancing adjustments.

Amalgamation without sale of assets of the amalgamating company

2. The amalgamating company is treated for profits tax purpose on the day immediately before the amalgamation as having:

(a) ceased to carry on its trade, profession or business; and

(b) realized its trading stock in the open market.

3. The amalgamated company is treated for profits tax purpose on the date of amalgamation as having:

(a) continued to carry on the trade, profession or business of the amalgamating company by way of succession;

(b) qualified for annual allowances in respect of commercial/ industrial buildings or structures by way of its entitlement to the relevant interest subject to balancing charges on disposal not exceeding the aggregate of the allowances made to it and the amalgamating company;

(c) qualified for annual allowances in respect of machinery or plant by reference to reducing values still unallowed subject to balancing charges on disposal not exceeding the aggregate of allowances made to it and the amalgamating company;

(d) qualified for any allowances/deductions under sections 16B, 16E, 16EA, 16F, 16G and 16I that the amalgamating company would have been allowed but for the amalgamation, subject to the assessment of proceeds as trading receipts on sale;

(e) been entitled to deductions that the amalgamating company would have been allowed but for the amalgamation; and

(f) earned the amount that would have been income or trading receipt of the amalgamating company but for the amalgamation.

4. The amalgamated company will be granted in the year of assessment in which the amalgamation takes place, annual allowances in respect of the commercial/industrial buildings or structures, and machinery or plant, and allowances/deductions under sections 16B, 16E, 16EA, 16F, 16G, and 16I. Such allowances and deductions will not be granted to the amalgamating company in the same year of assessment.

Tax losses

5. Tax losses are specific to a company and cannot be transferred to other group companies. Group loss relief and deduction for acquired losses through court-free amalgamation procedure are not to be allowed.

6. Tax losses brought forward in the amalgamated company can be used to set off against profits derived from the trade or business succeeded from the amalgamating company if:

(a) the amalgamated company has adequate financial resources (excluding intra-group loans) to purchase the trade or business of the amalgamating company other than through amalgamation (financial resources test);

(b) the amalgamated company was carrying on a trade or business until the amalgamation (trade continuation test); and

(c) such losses were incurred after the amalgamating company and the amalgamated company had become wholly owned subsidiaries of the same group (post entry test).

If not all the conditions are met, the tax losses can only be used to set off against the profits derived by the amalgamated company from its own trade or business.

7. Tax losses brought forward from the amalgamating company can only be used to set off against the profits of the amalgamated company derived from the same trade or business succeeded from the amalgamating company (same trade test).

Appendix 2

Summary of Special Tax Treatments in Schedule 17J

Section	Item	Tax treatment for amalgamating company	Tax treatment for amalgamated company
3	Succession of business	Not applicable	Treated as being carried on the business in Hong Kong beginning on the date of amalgamation
	Succession of asset (excluding trading stock) without reclassification	Not applicable	Treated as having acquired the assets on the same date and at same amount as incurred by the amalgamating company
4 and 5	Succession of asset (excluding trading stock) with reclassification	- Deemed as having sold the asset at market value on the date of amalgamation - Deemed sale proceeds to be brought into account in ascertaining profits chargeable to tax or in computing any balancing charge or allowance for the year of cessation	Deemed as having purchased the asset at the same market value from the amalgamating company
6	Succession of trading stock – used by the amalgamated company as trading stock		
	(a) Trading stock accounted for in financial account of amalgamated company at carrying amount of amalgamating	- Section 15C not applicable (i.e., no deemed sale of the trading stock)	- Deemed as having purchased the trading stock at carrying amount of amalgamating company - Unrealized gain or loss not yet been assessed under the amalgamating company to

	company (i.e., merger method adopted)		treated as unrealized gain or loss of the amalgamated company and will be brought into account when the trading stock is realized or in accordance with applicable tax treatment
7	(b) Trading stock accounted for in financial account of amalgamated company at value different from carrying amount of amalgamating company (i.e., acquisition method adopted)	- Deemed as having sold the trading stock for a consideration equal to the value reflected in amalgamated company's accounts on the date of amalgamation - Profit arising from the deemed sale to be brought into account for the year of cessation	Deemed as having purchased the trading stock for a consideration equal to the value as reflected in its financial account on the date of amalgamation
8	Succession of trading stock – not used by amalgamated company as trading stock	- Section 15C applies - Trading stock to be valued at the market value on the date of cessation of business for the purpose of computing profits chargeable to tax	Deemed as having purchased the trading stock for a consideration equal to the same market value applied to the amalgamating company
9	Cancellation of shares of amalgamating company ***(second company)*** held by another amalgamating company ***(first company)***	- The first company being deemed as having sold the shares in the second company immediately before the date of amalgamation at cost	In respect of any borrowings by the first company for acquiring shares of the second company, no deduction allowable for any interest or borrowing costs incurred by the amalgamated company on or after the date of amalgamation, unless the shares were held by the first company on revenue account and the relevant expenses are incurred in the production of

			the amalgamated company's chargeable profits
10	Succession of machinery or plant, or rights or entitlement to rights, related to R&D activities	- Not deemed as having any trading receipt	- No further deduction to be allowed - Sale proceeds or compensation received, restricted to amount of deduction allowed to the amalgamating company, to be treated as a trading receipt on subsequent disposal, sale, destruction or occurrence of a specified event
11	Succession of patent rights or rights to any know-how		
14	Succession of prescribed fixed assets		
15	Succession of environmental protection facilities		
12	Succession of specified intellectual property rights	- Entitled to claim deduction of capital expenditure for the year of cessation - Not deemed as having any trading receipt	- Entitled to claim the balance of deduction - Sale proceeds, restricted to total amount of deductions allowed to the amalgamating company and the amalgamated company, to be treated as a trading receipt on subsequent sale or occurrence of a specified event
13	Succession of refurbished buildings or structures	- Entitled to claim deduction of capital expenditure for the year of cessation	- Entitled to claim the balance of deduction
16 and 17	Succession of commercial or industrial buildings or structures	- Entitled to claim annual allowance for the year of cessation - No balancing charge or balancing allowance would be made	- Not entitled to claim initial allowance - Entitled to claim annual allowances for the years subsequent to the year of cessation of the amalgamating company
18 and 19	Succession of machinery or plant not		

	related to R&D activities		- Allowances granted to both the amalgamating company and the amalgamated company to be taken into account in computing the balancing charge or balancing allowance upon arising of an event mentioned in section 35(1)(a), 38(1) or 39D, or occurrence of a specified event
20	Special payment under recognized retirement scheme	Entitled to claim deduction of special payment for the year of cessation	Entitled to claim the balance of deduction
21	Bad debts, impairment losses, expenditure or losses recognized after amalgamation	Not applicable	Entitled to the deduction if the amalgamating company would have been allowed the deduction but for the amalgamation
22	Debt recovered or impairment loss reversed	Not applicable	The debt recovered or released being treated as a trading receipt if the amount would have been treated as the amalgamating company's trading receipt but for the amalgamation
23	Release of debt		
24	Pre-amalgamation losses of amalgamating companies	Not applicable	Allowable to be used to set off against assessable profits derived from the business succeeded from the amalgamating company subject to the following conditions: - Same trade condition - Post entry condition - Commissioner's satisfaction condition

25 and 26	Pre-amalgamation losses of amalgamated companies	Not applicable	Not allowed to be used to set off against assessable profits derived from the business succeeded from the amalgamating company unless all of the following conditions are met: - Financial resources condition - Trade continuation condition - Post entry condition - Commissioner's satisfaction condition
27	Irrevocable election	Not applicable	Treated as having made the same irrevocable election
28	Income accrued or derived after amalgamation	Not applicable	The income or refund being deemed as a trading receipt if the amount would have been deemed as the amalgamating company's trading receipt but for the amalgamation
29	Refund from approved retirement scheme after amalgamation		

Appendix 3

Advance Ruling Application

Required information and documents:

Organisation

1. A group chart with full details of the group companies, incorporated in Hong Kong or elsewhere, immediately before the amalgamation. This should include the name of each company, the direct and indirect interest of the ultimate holding company in each company.

2. A group chart with full details of the group companies, incorporated in Hong Kong or elsewhere, immediately after the amalgamation. This should include the name of each company, the direct and indirect interest of the ultimate holding company in each company.

3. The details of each of the companies which was/will be under the amalgamation. This should include the following information:

   (a) company name;
   (b) trade name;
   (c) business registration number;
   (d) business address;
   (e) business nature;
   (f) number of employees for the year of amalgamation and the preceding year.

Amalgamation

4. The reasons for carrying out the amalgamation.

5. The result that the amalgamation intended to achieve or has achieved.

6. The non-tax purposes of the amalgamation and any alternative way that the non-tax purposes could be achieved.

7. The estimated profits tax saving resulting from the amalgamation and the basis of estimation.

8. The reasons for selecting the company as the amalgamated company (if under horizontal amalgamation).

9. Copies of directors' minutes approving the amalgamation.

10. The functions of each company involved in the amalgamation immediately before and after the amalgamation.

Succession of business

11. Details of the amalgamating company's businesses and assets which were succeeded by the amalgamated company.

12. Details of changes in the modes of operations in respect of each of the businesses succeeded from the amalgamating company (if any) and the reasons for the changes (if applicable).

13. If any of the businesses of the amalgamating company was sold or transferred to a person other than the amalgamated company, provide the following information and documents:

    (a) the name and business registration number of the purchaser/ transferee;
    (b) the relationship between the amalgamated company and the purchaser/transferee, if any;
    (c) the consideration for the sale/transfer;
    (d) the reasons for the sale/transfer;
    (e) copies of directors' minutes approving the sale/transfer of the relevant business.

Pre-amalgamation loss

Amalgamating company

14. A detailed breakdown of the pre-amalgamation losses of the amalgamating company showing in each case the date on which the loss was incurred and the details of the business in which the loss was incurred.

15. Whether the business carried on by the amalgamating company immediately before the amalgamation was succeeded by the amalgamated company and if yes, any changes in the mode of operations of the relevant business.

16. The date on which the amalgamating company became a wholly owned subsidiary of the amalgamated company; or the respective dates on which the amalgamating company and the amalgamated company became a wholly owned subsidiary of their holding company.

17. If the loss was the amalgamating company's share of loss of a partnership in which it is a partner, provide the following information:

    (a) the name of the partnership;
    (b) the business registration number of the partnership;
    (c) details of the partners and their respective share of interest in the partnership;
    (d) whether the amalgamating company's interest in the partnership was succeeded by the amalgamated company.

Amalgamated company

18. Evidence to prove that the amalgamated company has financial ability (excluding loans from associated corporation) to acquire the business of the amalgamating company other than by amalgamation.

19. Whether the amalgamated company was carrying on a business immediately before the amalgamation. If yes, the details of the business.

20. A detailed breakdown of the pre-amalgamation losses of the amalgamated company showing in each case—

(a) the date on which the loss was incurred;
(b) the details of the business to which the loss was related;
(c) whether the amalgamated company has continued to carry on a business since the date the loss was incurred up to the date of amalgamation; and
(d) if the loss was a share of loss of a partnership in which the amalgamated company was a partner, whether the partnership has continued to carry on a business since the date the loss was incurred up to the date of amalgamation.

21. The date on which the amalgamating company became a wholly owned subsidiary of the amalgamated company; or the respective dates on which the amalgamating company and the amalgamated company became a wholly owned subsidiary of their holding company.