

Tax Guidance on Court-free Amalgamation in Hong Kong Issued by IRD

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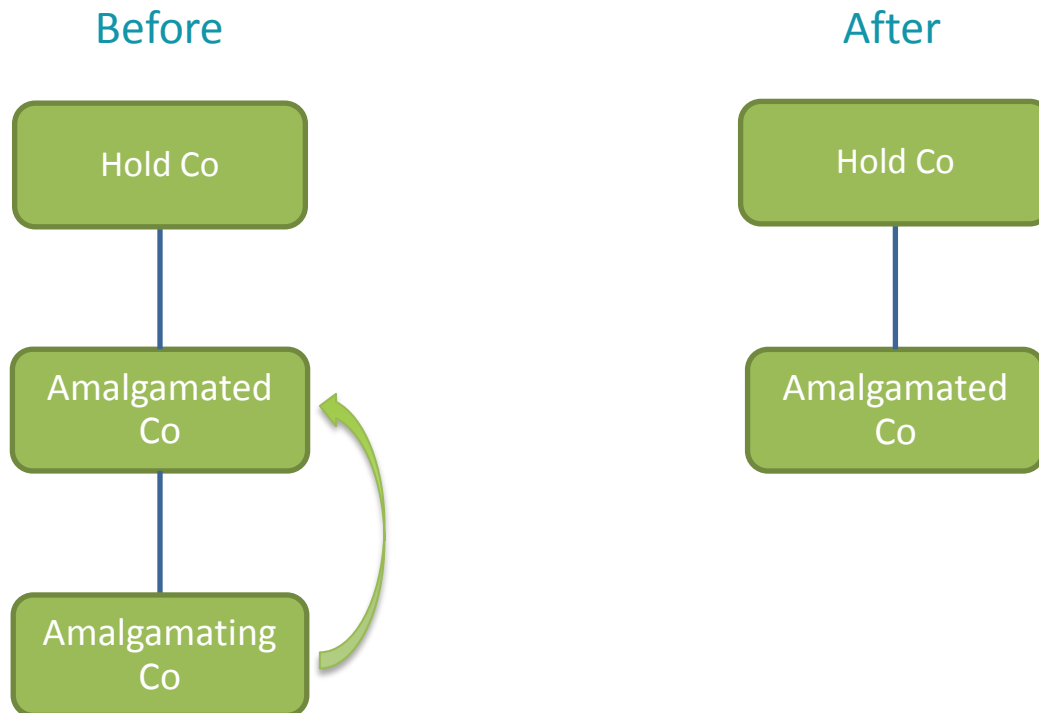
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What is court-free amalgamation?

- Introduced by the new Companies Ordinance (Cap. 622) on 3rd March 2014.
- Amalgamation of wholly-owned intra-group companies can be carried out without involving a court procedure.
- Facilitated intra-group restructuring through this simple and less costly amalgamation regime.
- However, no relevant tax legislation or guidance was provided by IRD, which led to the considerable uncertainty of tax treatment on this regime.

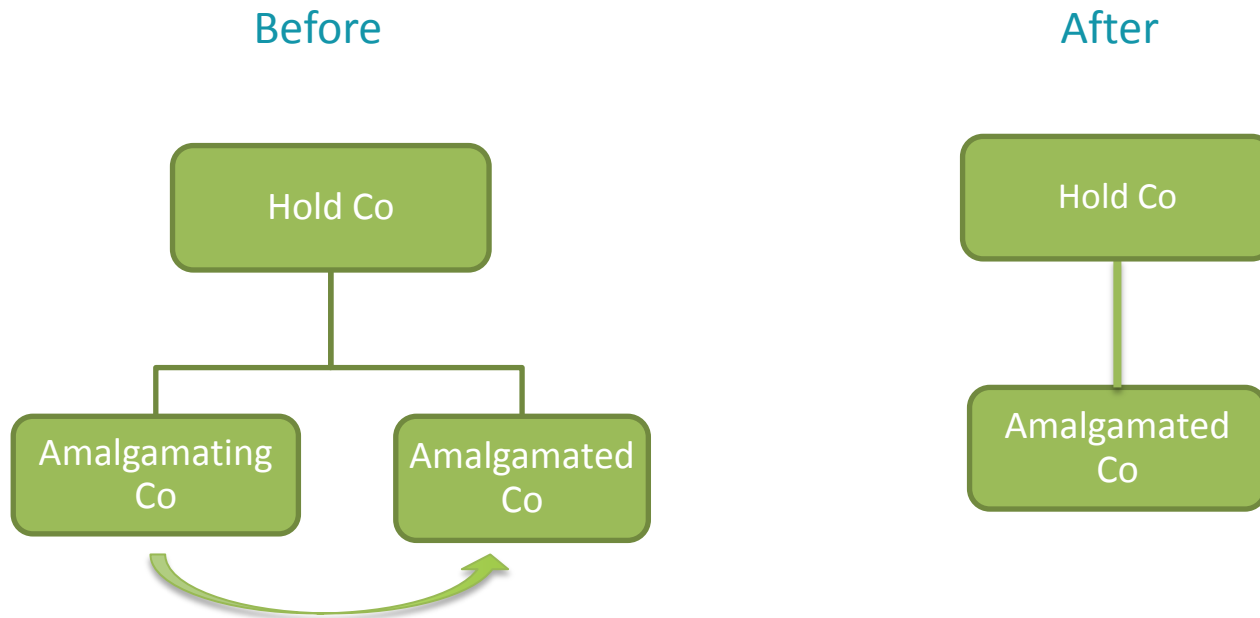
Court-free amalgamation

Vertical amalgamation



Court-free amalgamation

Horizontal amalgamation



What are the legal results of court-free amalgamation?

- The amalgamating company ceases to exist.
- The amalgamated company succeeds to all the rights, liabilities, assets of the amalgamating company.
- Similar to the universal succession.

What is the tax guidance on court-free amalgamation?

- On the 30th of December 2015, the Hong Kong Inland Revenue Department issued a guidance on tax consequences of court-free amalgamation under the new Companies Ordinance.
- The guidance clarifies that there shall be difference between the profit tax consequences of a court-free amalgamation and those of specific private merger or universal succession.
- Sections 61A and 61B (e.g. the denial of losses carried forward) will not be applicable, provided the amalgamation is not aiming to obtain tax benefits.

What are the practical solutions provided by the new guidance?

- The amalgamated company will be treated as far as possible as the continuation of the amalgamating company for tax purposes.
- The trading stock in the open market of the amalgamating company will be deemed as realized upon amalgamation.
- Tax losses can be set off against the profits of amalgamated company under certain conditions.
- The amalgamated company will be regarded as having qualified for allowances (e.g. allowance on commercial / industrial buildings).
- The amalgamated company will be treated as having entitled to deduction and having earned income which would have been allowed or earned without amalgamation.
- Formal and procedure rules (e.g. notification requirements) are provided.

What are the conditions for loss deduction to be granted?

- Tax losses can be used to set off against the profits of the amalgamated company in the following situations:
 - Losses are incurred after the amalgamating company and the amalgamated company have become wholly owned subsidiaries of the same group;
 - Losses are carried forward by the amalgamating or amalgamated company in a trade or business, which continues until amalgamation;
 - Tax losses if brought forward in the amalgamated company, the amalgamated company has adequate financial resources (excluding intra-group loans) to purchase the trade or business if not via amalgamation;
 - Tax losses if 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.
- In addition, the guidance suggests that the advance ruling should seriously be consider if tax losses are material in quantum.

Conclusion

- The new guidance provides practical solutions to tax issues arisen from court-free amalgamation regime.
- According to the new guidance, favorable tax treatment (e.g. loss deduction) may be utilized upon amalgamation.
- The amalgamation may also result in tax exposure (e.g. deemed realization of trading stock).
- There are still uncertainties (e.g. salaries tax impact) which are pending for further amendment of Inland Revenue Ordinance.

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