



Hong Kong Tax Newsflash

Views exchanged during the 2020 annual meeting between the Inland Revenue Department and HKICPA



The Hong Kong Institute of Certified Public Accountants' (HKICPA) Taxation Faculty's annual meeting with the Inland Revenue Department (IRD) was held on 15 May 2020. The discussions covered a wide range of tax topics and this article¹ summarizes the views exchanged on the key questions.

Corporate treasury centres

Question:

Under the current regime, qualifying corporate treasury centres (CTC) can enjoy 50% of the profits tax rate for income from qualifying treasury activities. Would an intra-group finance lease business be considered as a "qualifying corporate treasury activity" under the preferential tax regime?

Answer:

As the provision of finance leases for the purchase of plant and machinery is not an activity or a transaction specified in the definition of any one of the three types of activities mentioned in section 14C(1) of the Inland Revenue Ordinance (IRO) – the legislation for the CTC tax regime – a group finance lease business would not qualify for the CTC tax regime.

Tax deduction for lease payments

Question:

Based on our recent discussion with the IRD, the IRD would allow tax deduction on rental payment of a lease term under Hong Kong Financial Reporting Standard (HKFRS) 16 *Leases* based on the amounts charged to the profit and loss account. Is claiming tax deduction based on cash outflow/contractual commitment an acceptable alternative to the IRD?

Answer:

- Tax deduction of expenses is governed by sections 16 and 17 of the IRO. HKFRS 16 should not have any effect on the total amount of cash flows reported. Therefore, adoption of HKFRS 16 would not affect the operation of sections 16 and 17 of the IRO. It is a matter of timing difference between the amount charged to the profit and loss account and contractual commitment.
- In the example given, the deductible expenses would be the amounts charged to the profit and loss account in the respective years.
- Tax adjustment on the opening balance of retained earnings on first adoption of HKFRS 16 should be done in the year of first adoption.
- If taxpayer opted for early adoption of HKFRS 16 and claimed tax deduction on the actual cash outflow basis, it is not necessary to re-open the prior year assessments, but provide a reconciliation schedule together with the current year tax return.

Note:

Subsequent to the annual meeting, the IRD issued official guidelines on the profits tax treatment of leases where HKFRS 16 applies and confirmed that they also allow deductions based on contractual payments as long as such basis is consistently applied.

Greater Bay Area tax subsidy

Question:

The nine Mainland cities of the Greater Bay Area currently provide tax subsidies to qualified foreign high-end talents and talents in short who work in these cities. These subsidies are currently non-taxable items in the hands of the recipients for Mainland China individual income tax purposes. Are these subsidies taxable for Hong Kong salaries tax?

Answer:

The subsidies, whether or not in the nature of income from employment, should be wholly attributable to the taxpayers' services in the Mainland. Therefore, it is likely that the tax subsidies would not fall within the charge to salaries tax under section 8(1A)(a) of the IRO.

Tax treatment of housing benefits provided by a third party

Question:

If a non-Hong Kong employer assigns its foreign employee to work in an office of an unrelated third party client in Hong Kong, the client would provide rent-free accommodation to the foreign employee during the assignment period. Will the rent free accommodation be deemed as income (i.e., rental value) for salaries tax purpose?

Answer:

- The arrangement has to be examined in detail to find out if the non-Hong Kong employer provides rent free accommodation to its employee through the unrelated client.
- If the answer to the above question is yes, then the rental value of such accommodation has to be subject to salaries tax under sections 9(1)(b) and 9(2) of the IRO.

Royalty payments to overseas non-resident**Question:**

Where a Hong Kong taxpayer paid royalties to an overseas related party, are these transactions required to comply with the arm's length principle? Or can these transactions be regarded as specified domestic transactions? Consider the two cases detailed in section 21A of the IRO. In the first case 100% of the royalty income of the overseas related party are deemed as taxable receipt where the intellectual property (IP) was once owned by a Hong Kong taxpayer. In the second case, 30% of the royalty income of the overseas related party are deemed as taxable receipt as the IP had never been owned by a Hong Kong taxpayer?

Answer:

- The overseas recipient that fell within the deeming provision for royalties of section 15(1) was not regarded as having carried on a business in Hong Kong for the purpose of the transfer pricing provision in section 50AAJ(3). Therefore the domestic nature condition was not met and it is not necessary to further consider whether the no actual tax difference condition was met in both scenarios.
- The transfer pricing provision in section 50AAF is applicable to both cases and income or loss in relation to the royalty transaction should be computed on arm's length basis.
- The Hong Kong associate royalty payer is also required to include the transaction in its local file under the transfer pricing documentation provision section 58C(2).

Double tax relief for withholding tax on royalty income**Question:**

Suppose a Hong Kong licensor enters into an annual licensing agreement with an overseas licensee with royalties for 10 years. The licensor recognizes all royalties in year 1 according to HKFRS 15 *Revenue from Contracts with Customers*. Currently, tax credit can only be claimed before the end of six years after the end of the relevant year of assessment provided that withholding tax has been paid overseas. How can the licensor claim double tax relief for years 7 to 10 in Hong Kong?

Answer:

Where a claim for tax credit could not be made within the timeframe specified in the legislation, the taxpayer might present a case for mutual agreement procedures (MAP) under the relevant comprehensive double taxation agreement (CDTA). Any MAP solution reached should be given effect despite any provision in the IRO.

Refunds to non-residents

Question:

Where a non-resident person was assessed for certain receipts (e.g. royalties) in the name of the payer in Hong Kong and paid excessive tax, refund cheques of “Non-Resident Profits Tax Returns” filings would normally be issued under the name of “HK Co for non-resident Co” which could not be banked. The cumbersome administrative procedures of requesting the reissuance of a cheque to a designated payee create hardship to the non-resident person in getting the refund. Could the IRD simplify the process for reissuance of refund check in the name of the non-resident?

Answer:

- To simplify the refund process, the IRD plans to upload a template letter of indemnity onto its website. Upon receipt of the refund notice from the IRD, either the payer in Hong Kong or the non-resident person could download the template for completion.
- The duly completed letter of indemnity, the refund cheque, together with a proper written request for amendment of payee’s name should be sent to the IRD for processing.

Certificate of Residence for offshore economic substance law purpose

Question:

Under the economic substance (ES) laws of offshore jurisdictions, entities that are tax residents in other jurisdictions are not subject to their ES requirements. A Certificate of Residence (CoR) would be a strong proof to these jurisdictions in accepting a taxpayer’s tax residence in Hong Kong. However, under the current IRD's practice, CoR applications for purposes other than claiming tax benefits under tax treaties would not be entertained. Would the IRD consider issuing a special class of CoR or other documentation proof for serving the offshore ES law purpose or other non-treaty purpose?

Answer:

- It would be against international practice for the Hong Kong competent authority to issue a CoR, in the absence of a CDTA, to offshore entities for the purpose of exempting them from obligations regarding substantial activities requirements.
- Therefore, the IRD has no plan to issue a special class of CoR or other documentation proof for serving the offshore ES law purpose or other non-treaty purpose.
- Taxpayers may request the IRD to issue a letter to confirm the factual tax information of the taxpayers, e.g. confirmation of tax payment. However, whether the information on such document would be regarded as relevant remained a matter for the foreign jurisdictions to determine.

Completion of Supplementary Form S2 of the Profits Tax Return

Question:

The IRD’s guidelines on the completion of Supplementary Form S2 – transfer pricing do not contain any definition of “transactions”. Should transactions which would not result in any impact to the income statement, e.g., interest free loans, be reported?

Answer:

- The term “transaction” was defined in the transfer pricing provision, section 50AAI(1), to include any operation, scheme, arrangement, understanding and mutual practice (whether express or implied, and whether or not enforceable or intended to be enforceable by legal proceedings).
- Paragraphs 43 to 46 of DIPN 59 explained with examples the terms “transaction” and “a series of transactions”.
- Transactions that fall within the definitions need to be reported even if there are no transfer pricing adjustments and no changes in the intercompany balances during the year.

E-filing of tax returns

The IRD is developing three interconnected portals, namely Business Portal, Individual Portal and Tax Representative Portal. These are planned to be rolled out in 2025. During the meeting, questions were raised about the portals.

Question:

What is the timetable for extending the e-filing system for Tax Return - Individuals (BIR 60), so that more individuals in Hong Kong can file electronically, including those with income exemption and double tax relief claims? Is there any plan to allow tax representatives to e-file their clients' BIR 60?

Answer:

- In designing and developing the Tax Representative Portal, the IRD will consider enabling tax representatives to file BIR 60 for their clients.

Question:

The IRD advised in the 2019 annual meeting that it would consult the stakeholders in the development of the Business Portal and Tax Representative Portal for profits tax. What is the current status?

Answer:

- The Business Tax Portal would facilitate submission of tax returns by businesses together with accounting and financial data.
- The Tax Representative Portal would enable tax representatives to conduct e-transactions on behalf of their clients, both individuals and businesses.
- In the interim, the existing eTax portal would be enhanced to cater for submission of financial statement and tax computations in the form of data files. It is expected that the enhanced eTax portal would be able to accept e-filing of profits tax return (BIR 51 or BIR 52) for a taxpayer by a service provider, subject to the relevant legislative amendments.

Though not legally binding, the answers provided by the IRD during the meeting serve as good guidance on the tax issues many taxpayers are facing.

¹ The original article was published in HKICPA journal, A-Plus on 5 October 2020.

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