



# Taxes

106

Hong Kong's tax rates are the lowest of any major Asian location and among the lowest in the world. In general, only income from business profits, employment and property actually arising in or derived from Hong Kong are subject to Hong Kong tax. Only profits arising in Hong Kong from a trade, profession or business carried on in the territory are taxable.

A company pays no tax in Hong Kong on income derived from outside Hong Kong. Salaries tax is also only charged on employment income arising in or derived from Hong Kong ie, income derived from a Hong Kong employment or income of services rendered in Hong Kong under a foreign employment. Taxes on different types of income are assessed separately.

With the exception of business profits, all taxes are assessed on a fiscal year basis ending March 31st. Companies, partnerships or proprietorships will have their profits assessed on the accounting year basis.

Hong Kong's tax system is one of the many reasons companies choose Hong Kong as their Asia Pacific headquarters. Dividends or overseas branch profits repatriated to Hong Kong are not subject to Hong Kong tax. In addition, dividends paid by a Hong Kong company to its shareholders are not subject to Hong Kong tax, nor is there any withholding tax on dividends paid to shareholders outside Hong Kong. Capital gains are also tax exempt. Stamp duty is imposed on certain documents such as share transfers, leases and sales of real property. A fixed amount applies to some documents, duty on others increases with the value of the transaction.

## PROFITS TAX

Profits tax is levied on every 'person' carrying on a trade, profession or business in Hong Kong in respect of 'his' assessable profits arising in or derived from Hong Kong. The term 'person' refers to all business entities. The rules for determining the source of profits have been vigorously disputed in recent years. To minimize disputes, the Commissioner of the Inland Revenue has provided a summary of her views concerning the rules of determining source



and how these rules are to be applied to various types of income in the Departmental Interpretation & Practice Notes 21 entitled 'Locality of Profits' (revised 1998). The practice note explains the view of the Inland Revenue Department (IRD) in the treatment of income sourced from trading, manufacturing, services and financial institutions and the favorable tax treatment where a branch is set up in Hong Kong to act simply as a buying office. There is a procedure for obtaining an advance ruling on the source of profits detailed in Departmental Interpretation & Practice Notes 31.

Profits tax is levied at the flat rate of 17.5 percent on limited companies. Unincorporated businesses are taxed at 16 percent. To calculate net assessable profits, the taxpayer may deduct expenses incurred to produce taxable income. Such expenses include the usual administrative charges, interest expenses and other related expenses which satisfy both the general and specific provisions as laid down in the Inland Revenue Ordinance (IRO).

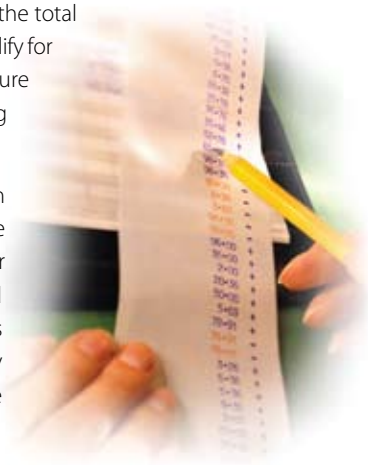
Losses can be carried forward and set off against future profits of that business.

A corporation carrying on more than one commercial activity may have losses in one trade offset against profits of the other.

Depreciation provided for accounting purposes is not deductible, but the IRO provides generous depreciation allowances in respect of capital expenditure incurred on the cost of construction of industrial or commercial buildings and structures, and capital expenditure incurred on plant and machinery used for the production of chargeable profits.

For plant and machinery, depreciation allowances are allowed at 60% of capital expenditure when the expenditure was incurred. Annual depreciation allowance is allowed at 10%, 20% or 30% on a reducing balance basis depending on the type of assets. Initial allowance of 20% on capital expenditure incurred in the construction of industrial buildings and structures; an additional 4% per annum thereafter until the total expenditure is written off. A commercial building can qualify for an annual allowance of 4% per annum. Capital expenditure on computer hardware, software and manufacturing machinery can be deducted in the year it is incurred.

Hong Kong also has instituted a generous tax deduction for research and development. Deductible items include expenditure on market research, feasibility studies, other scientific research activities related to business and development activities that applying research findings to the production or introduction of new or substantially improved materials, products or systems prior to the commencement of their commercial production or use.



Foreign companies carrying on business in Hong Kong through a branch or an agent having the general authority to conduct business on their behalf are subject to profits tax and are generally treated in the same way as domestic companies. One tax issue facing foreign companies is that of separating profits arising in Hong Kong from other profits. A Hong Kong branch of a foreign company should maintain its own books so that it may file financial statements with the IRD that clearly reflect the profits arising from the branch's activities. If such books are not kept, IRD may require the financial statements of the foreign company and determine Hong Kong-source profits by the formula: Hong Kong income divided by worldwide income, multiplied by worldwide profits or a fair percentage of the turnover of the Hong Kong branch.

## SALARIES TAX

Salaries tax is levied on income received by employees from Hong Kong sourced employments and pensions. With certain exceptions, the income subject to salaries tax includes salaries and wages, commissions, bonuses, cost-of-living allowances, education benefits, similar employer-paid perquisites and stock option gains, etc. Incomes of a husband and his wife are separately assessed in their own names, but they may jointly elect to have their income aggregated for the purpose of computing the charge to salaries tax, if this would result in a reduction of total tax liabilities.

With effect from 2003/04 fiscal year, holiday journey benefits are subject to salaries tax irrespective of the mode of payments. Employer-paid or reimbursed housing cost is not directly taxable. Rather, an amount calculated at 4 percent or 8 percent or 10 percent of the assessable income, depending on types of accommodation leased, is simply added to reflect the taxable portion of housing provided.

In determining the assessable income, outgoings and expenses, other than expenses of a domestic or private nature and capital expenditure, wholly, exclusively and necessarily incurred in the production of the assessable income and depreciation allowances in respect of plant and machinery the use of which is essential to the production of the assessable income are deductible. Other deductions that are permitted include: (1) loss brought forward from previous years of assessment; (2) expenses of self-education paid; (3) elderly residential care expenses paid; (4) home loan interest paid; (5) contributions to recognized retirement schemes; and (6) donations to approved charities. The maximum deduction for home loan mortgage interest payments is HK\$100,000 for fiscal year 2007/08.

Net chargeable income is the taxpayer's assessable income less personal allowances, child allowances, dependent parent and single parent allowances, dependent grandparent allowances, disabled dependent and dependent sibling allowances. Salaries tax is then computed on net chargeable income at scaled rates between 2 percent and 17 percent for 2007/08 fiscal year. Overall tax liability cannot, however, exceed the standard rate of 16 percent applied to the taxpayer's assessable income.

*Pls go to [http://www.amcham.org.hk/hongkong/establishing\\_office.html](http://www.amcham.org.hk/hongkong/establishing_office.html) to view web edition supplements.*

## TIME OUTSIDE OF HONG KONG

For employees under foreign employment, only income of services rendered in from Hong Kong is subject to salaries tax. Thus these employees are able to allocate their remuneration for tax purposes on the basis of the time spent in and out of Hong Kong during the taxable year; the allocation is made by comparing the days spent in the territory with total days during the fiscal year. In the past, the IRD generally accepted that an employment as foreign employment and time basis is appropriate where the employment



contract is entered into, negotiated, concluded and enforceable outside Hong Kong, the employer is not resident in Hong Kong and the employee's income is paid wholly or partly to him by the non-resident employer outside Hong Kong. However, the IRD's current practice is to adopt the "totality of facts" approach in reviewing an individual's time basis claim. That is, besides the above three factors, other surrounding factors (e.g. to whom does the employee report to; whether a Hong Kong company is stated as the employer in the employee's work visa application documents; whether the employee's remuneration is borne by an entity in Hong Kong; and whether the employee enjoys local benefits, etc.) will be reviewed

before the IRD determines whether to accept the claim. Persons who perform services in Hong Kong during visits for not more than 60 days in any year of assessment are exempt from salaries tax. It must be emphasized that there is no definition of "visits" in the IRO and visits generally refer to a short or temporary stay. The IRO provides for double taxation relief for both foreign and local Hong Kong employees where employment duties are performed in another country. Income for services performed outside Hong Kong on which the equivalent of salaries tax has been paid to another country will be exempt from Hong Kong salaries tax.

## BASIS OF ASSESSMENT

Liability to salaries tax is based on the actual income of the year of assessment, but an initial charge is made for a provisional salaries tax. That is, the taxpayer will pay an estimated tax first (based on expected income for that tax year) and then at the end of the tax year will receive a follow-up bill for any additional tax owed. Salaries tax is not deducted from regular employee paychecks; hence employees should remember to set aside money to pay the end-of-the-year salaries tax.

## EMPLOYER'S OBLIGATIONS

In addition to the filing of the annual Employer's Returns (Form IR56B) for its employees to the IRD by end of April each year, an employer has the following reporting obligations:

- △ *Filing of Commencement Notification (Form IR56E) within three months of the date of commencement of employment*
- △ *Filing of Cessation Notification (Form IR56F) one month prior to the anticipated termination date*
- △ *Filing of Departure Notification (Form IR56G) one month prior to the anticipated departure date*

## SALARIES TAX COMPUTATION

The IRD has developed a simple salaries tax computation program to help you calculate your own salaries tax liability. All you have to do is to select the assessment year, marital status, input your income and the number of your dependents and then press the "Compute" button at the bottom of the input page. Another page will appear which shows you your exact salaries tax liability.

Since 2003/2004, salaries tax taxpayers may choose to file their tax return electronically through the Internet.

## PROPERTY TAX

Property tax is charged to the owner of land or buildings in Hong Kong at the standard rate of 16% on rent receivable (excluding rates paid by owner and irrecoverable rent), less an allowance of 20 percent for repairs and maintenance. Property owned by a corporation carrying on business in Hong Kong is exempt from property tax, but income derived from the letting business is chargeable to profits tax.

## TAX ON INTEREST INCOME

Hong Kong abolished interest tax, which was previously levied on individuals and companies that were not carrying on a trade or business in Hong Kong, but receiving Hong Kong source interest income. Individuals and companies, which are carrying on a trade or business in Hong Kong, are taxed under Profits tax on all Hong Kong sourced interest apart from bank deposits. Interest derived from bank deposits, whether offshore or otherwise, would be free from profits tax.

## COMPOSITE TAX RETURN

From 1993/94, IRD introduced a system for all individuals to complete and file one combined tax return, reporting all employment income, profits/losses from all solely owned unincorporated business and rental income from all wholly owned properties.

## PERSONAL ASSESSMENT

The IRO offers an individual taxpayer, either a permanent resident (ie individual who ordinarily resides in Hong Kong) or a temporary resident (ie individual who stays in Hong Kong, whether continuously or otherwise, for more than 180 days in a fiscal year or 300 days in two consecutive fiscal years), as defined under the IRO, to elect for 'personal assessment' if he derives income other than salaries and wages. If the election is made, all sources of income chargeable to salaries tax, property tax and profits tax will be assessed jointly. Tax payable on all sources of income is calculated in the same manner as salaries tax (ie at various progressive rates on total income less all allowances with an overall liability of not more than 16% of total assessable income). Election of personal assessment also allows the taxpayer to deduct interest expenses on the money borrowed for producing taxable income liable to property tax (deductible interest is limited to the amount of net assessable value liable to property tax), as well as to use agreed losses under profits tax to set-off against other sources of income.

## OTHER MATTERS

**Tax Administration.** The IRO is administered by the Commissioner of Inland Revenue. The Commissioner does not have power to amend legislation, but may propose amendments to the Financial Secretary. The IRD publishes Departmental Interpretation and Practice



Notes that set out the IRD's interpretation of certain tax issues. These notes do not have the force of law, but a taxpayer who opposes them must be prepared for a legal battle.

**Income Subject to Tax in Other Countries.** Until June 2001 Hong Kong had no comprehensive double taxation agreements in place. Since under the "territorial principle" only income that either arises in or is derived from Hong Kong is taxable the double taxation of income does not usually occur, thereby obviating the need for double taxation treaties. Income relating to other countries generally falls outside the scope of the charge. As a result (with exception of the legislation regarding salaries tax mentioned above), any taxes related to such income are ignored by the IRD. However, the HK SAR Government has negotiated and executed comprehensive double taxation treaties with some foreign countries.

The first comprehensive double tax agreement was made with Belgium in 2003 and has been in force since 2004. In 2005 HK SAR Government signed the second comprehensive double tax agreement with Thailand. Apart from these double tax agreements, the Mainland Chinese and Hong Kong revised the 1998 double tax arrangement in 2007 to cover all types of income and to include the provisions in the OECD double tax agreement model.

For transportation income only, Hong Kong has made double taxation relief arrangements relating to shipping activities with Germany, Netherlands, United Kingdom, United States, Norway, Denmark, Singapore, Sri Lanka and relating to aviation activities with the United Kingdom, Israel, Mauritius, Croatia, Korea, Bangladesh, New Zealand, Germany, Iceland, Canada, Denmark, Sweden, Norway, Netherlands, Kenya, Kuwait and Switzerland. Double taxation relief arrangements relating to aviation activities have been made with Estonia, Finland, Jordan, Russian Federation and Macao SAR but the effective dates of these arrangements have not been formally announced.

**Assessments.** Hong Kong's tax system is currently not based on self-assessment, although it is being considered and is likely to be introduced some time in the future. Instead, taxpayers' tax returns are basically information filings that are examined by the IRD. Field Audits are becoming more common as a measure to ensure accurate filing of returns. The IRD is responsible for issuing tax assessments and tax collection.

**Payment of Tax.** Hong Kong does not require that tax be withheld on income from business profits, salaries (unless for departure case as described below) or property. The assessment, once issued, will specifically request payment of the actual tax due at a specified date. In addition, a payment of provisional (estimated) tax is also required to be paid for the ensuing year. The provisional tax is generally equal to the actual tax assessed for the preceding year. For salaries tax, the employer is required to withhold any payment of money or money's worth due to the departing employee for a period of one month from the date of Departure Notification (Form IR56G), or until a letter of release has been received from the IRD, whichever is earlier.

Payments made by a Hong Kong business entity to a non-resident for use of intellectual property in Hong Kong are deemed to be Hong Kong sourced receipts. The payer of the royalty shall withhold the tax payable by the non-resident and pay it to the IRD. The Department will issue an assessment to the payer as agent of the non-resident. The rate of withholding tax for such payments is either 5.25 percent or 17.5 percent of the royalties paid, depending on whether the payment is made between associated parties and a Hong Kong business has at any time in the past held an interest in the intellectual property for which payment is being made.

Please refer to the IRD's website: [www.info.gov.hk/ird](http://www.info.gov.hk/ird)

- *This section updated by Mona Mak, Tax Principal/Fergus Wong, Tax Director, Deloitte Touche Tohmatsu*