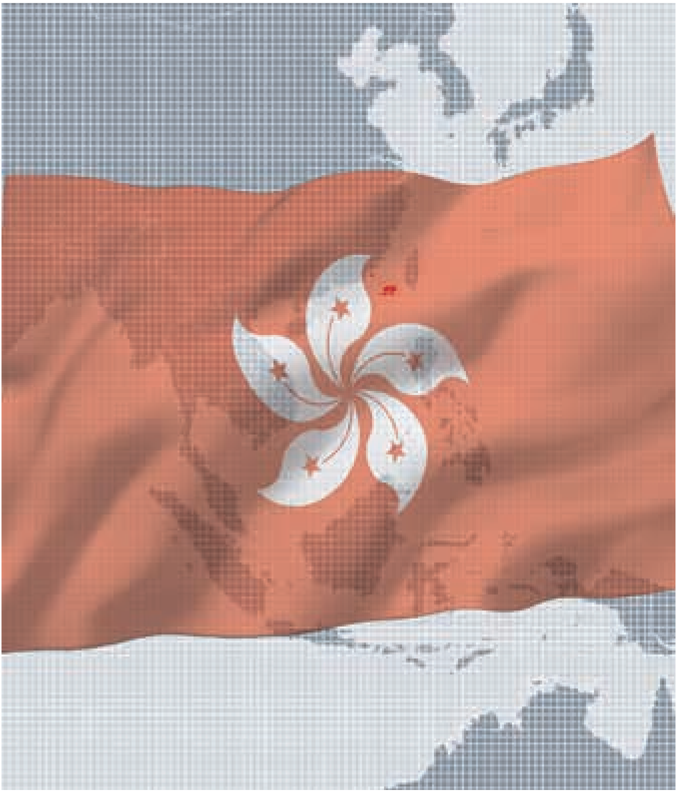
Hong Kong

TAX LEGAL CONSULTING

Tax and Investment Facts

A Glimpse at Taxation and Investment in Hong Kong



WTS consulting (Hong Kong) Limited
Hong Kong

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- Tax controversy services
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1 Types of Business Structure / Legal Forms of Companies

The most common legal forms of business in Hong Kong are the limited liability company, partnership, sole proprietorship, branch office of parent company and representative office. Most of the limited companies incorporated in Hong Kong are private companies limited by shares.

Hong Kong operates a territorial tax system. Profits tax (Hong Kong's corporate income tax) is therefore imposed only on taxable income or profits arising in or derived from Hong Kong, or deemed as such. Capital gains and receipts that are capital in nature are not subject to profits tax.

A company is subject to profits tax if all of the following criteria apply:

i. the company carries on a trade, profession, or business in Hong Kong, AND
ii. the profits to be assessed are from the trade, profession or business operated by the company in Hong Kong, AND
iii. the profits arise in or are derived from Hong Kong.

The guiding principle for the determination of the source of profits is what the taxpayer has done to generate profits and where he has done it. This requires identifying the activities that resulted in the profits generated. In other words, the operations that directly produced the relevant profits and the location where those operations took place must be identified.

Which activities actually led to the profits is a question of fact and has to be determined based on the circumstances of each individual case. This is a frequent subject of discussion and court cases between the Hong Kong tax authorities and taxpayers. Consequently, there is ample jurisprudence from the past decades.

2.1 Applicable Taxes / Tax Rates

Profits tax is levied at 16.5% for companies and 15% for unincorporated businesses. Hong Kong has no tax surcharges.

2.2 Resident Companies

A company is considered as resident in Hong Kong if its central management and control is exercised in Hong Kong (in the relevant year of assessment). However, because of the territorial tax system, tax liability in Hong Kong is not determined by residence status but rather by the source of income.

2.2.1 Computation of taxable income

The taxable income is based on the accounts prepared using generally accepted accounting principles and subject to certain tax adjustments.

a. Deductions allowed
   All payouts and expenses that are incurred in the production of chargeable profits are allowable for deduction.
b. Deductions not allowed
   Deduction is specifically prohibited for the following items:
   - Domestic or private expenses
   - Disbursements or expenses not used for the purpose of producing profits
   - Expenditure of a capital nature or loss or withdrawal of capital
   - Cost of improvements
   - Sums recoverable under an insurance or contract of indemnity
   - Rent of or expenses relating to premises not occupied or used for the purpose of producing profits
   - Tax paid or payable under the Inland Revenue Ordinance other than salaries tax paid in respect of the employees' remuneration

2.2.2 Taxation of dividends

Hong Kong does not levy any tax on dividends.

2.2.3 Capital gains and losses

Capital gains, such as those derived from the disposal of shares held for long term investment purposes, are generally not taxable in Hong Kong. However, the disposal of immovable properties might be taxable if the disposal is a speculative transaction, meaning that it has the nature of trading. The Inland Revenue Department (IRD) will consider several aspects when determining the taxpayer's intention.

Capital losses are not deductible.

2.2.4 Depreciation / Capital allowances

Depreciation allowance – plant and machinery	Rate	Comment
Initial allowance	60%	of qualifying capital expenditure incurred by taxpayers in the relevant year
Annual allowance	10%, 20% or 30%	on the declining value brought forward

Industrial buildings allowance	Rate	Comment
Initial allowance	20%	of qualifying capital expenditure incurred by the taxpayer in the relevant year
Annual allowance	4%	of cost or computed based on the residual expenditure

Commercial buildings allowance	Rate	Comment
Annual allowance	4%	of cost or computed based on the residual expenditure

2.2.5 Loss carry forward (including potential loss of tax loss carry forward in the event of restructuring)

Net operating losses can be carried over indefinitely. Losses cannot be carried back.

For partnerships, the loss can be deducted from the partnership's share of taxable profits in the same year of assessment and may be deducted from its taxable profits for later years of assessment or from its share of partnership profits for such later year.

2.2.6 Group taxation

Hong Kong does not allow group taxation. Consolidated filing is not allowed.

2.2.7 Relief from double taxation (tax credit / tax exemption)

Offshore income is generally not taxable in Hong Kong. Therefore, only foreign tax paid on onshore income can be credited against profits tax, if a respective double taxation agreement has been signed. The amount to be credited is limited to the profits tax payable on the same income.

2.2.8 Incentives

Hong Kong currently offers the following Incentives:

1) Immediate write-off for capital expenditure on plant and machinery specifically related to manufacturing, and on computer hardware and software owned by the end-users.
2) A 5-year write-off period for capital expenditure on the renovation or refurbishment of business premises.

3) Tax concessions for gains derived from qualified debt instruments.
4) Concessionary tax rate of 8.25% for offshore business of reinsurance companies and authorized captive insurance companies.
5) Exemption from payment of tax on interest derived from any deposit placed in Hong Kong with an unauthorized institution (not applicable to interest received by or accrued to a financial institution).
6) Offshore funds (non-resident funds) and offshore private equity funds (from 1 April 2015 onwards for the latter) can qualify for profits tax exemption if they meet certain criteria.
7) Accelerated deduction for capital expenditure on specified environmental protection facilities. For machinery or plant, 100% deduction will be allowed for the capital expenditure incurred. For installations forming part of a building or structure, 20% deduction will be allowed for each year for five consecutive years.
8) 100% deduction for capital expenditure on specified environmental-friendly vehicles.

2.3 Non-resident Companies

Please refer to 2.2. which applies equally to Hong Kong companies and those incorporated overseas.

2.3.1 Concept of permanent establishment / doing business

Non-resident companies are subject to profits tax if they fulfil the criteria listed under 2.2.1. Having a permanent establishment in Hong Kong can qualify the non-resident company as “carrying on a trade, profession, or business in Hong Kong” and render Hong Kong sourced profits taxable in Hong Kong.

Permanent establishments are defined as:

- Branches
- Management
- Other places of business
- Dependent agents who have and habitually exercise a general authority to negotiate and conclude contracts on behalf of a principal
- Agents who have a stock of merchandise from which they regularly fill orders on behalf of a principal.

2.3.2 Withholding taxes

Hong Kong does not generally levy any withholding taxes on dividends and interest, payments of management fees, fees for technical services and rental income.

Certain royalty payments made by a resident company to a non-resident company are subject to withholding tax. The amount deemed taxable is 30% of the gross payment. If the payment is made to an affiliated party, 100% of the gross payment is taxable. The respective withholding tax rates for incorporated companies are 4.95% or 16.5%, and 4.5% or 15% for unincorporated businesses.

2.4 Tax Compliance

The IRD takes an "assess first, audit later" approach to the assessment of tax returns.

Hong Kong's tax year starts on 1 April and ends on 31 March of the following calendar year. Profits tax returns are generally issued annually on the first working day of April. The filing deadline is 1 month after the tax return has been issued. Companies with a financial year ending between 1 December and 31 March and are represented by a tax representative can apply for a filing extension with the following due dates:

- 30 April of the following year, for accounting years ending between 1 April and 30 November
- 15 August of the following year, for accounting years ending between 1 December and 31 December
- 15 November of the same year, for accounting years ending between 1 January and 31 March

Companies must make prepayment (provisional tax payment) for the following tax year. The payment will be credited against the final tax payable. Excess payments will be refunded.

3 Double Taxation Agreements / Tax Information Exchange Agreements

3.1 Double tax agreements

As at 31 December 2015, Hong Kong has signed 33 double taxation treaties. The table below shows the withholding tax rates for dividends, interest and royalties paid from Hong Kong to corporate recipients of treaty and non-treaty countries.

Jurisdiction	Dividend (%)	Interest (%)	Royalties (%)[1]
Austria	0	0	3.00
Belgium	0	0	4.95
Brunei	0	0	4.95
Canada	0	0	4.95
China	0	0	4.95
Czech Republic	0	0	4.95
France	0	0	4.95
Guernsey	0	0	4.00
Hungary	0	0	4.95
Indonesia	0	0	4.95
Ireland	0	0	3.00
Italy[2]	0	0	4.95
Japan	0	0	4.95
Jersey	0	0	4.00
Korea[3]	0	0	4.95
Kuwait	0	0	4.95
Liechtenstein	0	0	3.00
Luxembourg	0	0	3.00
Malaysia	0	0	4.95
Malta	0	0	3.00
Mexico	0	0	4.95
Netherlands	0	0	3.00
Portugal	0	0	4.95

Jurisdiction	Dividend (%)	Interest (%)	Royalties (%)[1]
Qatar	0	0	4.95
Romania[3]	0	0	4.95
South Africa[2]	0	0	4.95
South Spain	0	0	4.95
Switzerland	0	0	3.00
Thailand	0	0	4.95
United Arab Emirates[2]	0	0	4.95
United Kingdom	0	0	3.00
Vietnam	0	0	4.95
Non-treaty countries	0	0	4.95

Negotiations for additional double taxation agreements are currently in progress with the following countries:

Bahrain	Bangladesh	Finland
Germany	India	Israel
Latvia	Macao	Macedonia
Mauritius	Pakistan	Russian Federation
Saudi Arabia		

Note

1 The withholding rates in Hong Kong applicable to individuals (including unincorporated business) and corporations are 4.5% and 4.95%, respectively. These rates are lower than those specified in the relevant tax treaties and consequently, the Hong Kong domestic rates apply.

2 With effect from 1 April 2016

3 Not yet in force

3.2 Tax information exchange agreements

Hong Kong has entered into several tax information exchange agreements to enhance the exchange of information with jurisdictions with which a comprehensive tax treaty has not been concluded. These countries are:

- Denmark
- Faroe Islands
- Greenland*
- Iceland
- Norway
- Sweden*
- USA

*The agreements have been concluded but have not yet entered into force.

4 Transfer Pricing

Hong Kong's regulations in terms of business carried between resident companies and closely connected non-resident companies are limited.

Parties are considered to be closely connected if they are substantially identical or the same person owns the controlling interest therewith.

In 2009 the IRD issued a Departmental Interpretation and Practice Note (DIPN) No 46, which is a guideline on transfer pricing applying OECD principles (e.g. arm's length and common transfer pricing methods). In addition, it lists the types of information required during transfer pricing inquiries, audits or investigation. The IRD also issued DIPN 45 and DIPN 48, which deal with double taxation relief in respect of transfer pricing adjustments and taxpayers seeking advance pricing agreements (APA), respectively.

5 Anti-avoidance Measures

5.1 General Anti-avoidance Rule

Transaction that is artificial or fictitious or the sole or dominate purpose of which is to obtain a tax benefit can be disregarded under the general anti-avoidance provision. In addition, specific provisions also disallow the set off of tax loss if the sole and dominant purpose of the change in shareholding in a corporation is to utilise tax loss.

5.2 Thin Capitalization Rules

Hong Kong does not have thin capitalization rules. The deduction of interest expenses is limited, especially with regard to non resident companies.

5.3 Controlled Foreign Company Provisions

Hong Kong has no provisions applicable to controlled foreign companies.

6 Taxation of Individuals / Social Security Contributions

6.1 Residency Rules

An individual will be considered as resident in Hong Kong, if the individual

- ordinarily resides in Hong Kong,
- stays in Hong Kong for at least 180 days per tax year OR
- stays in Hong Kong not less than 300 days in one tax year and the tax year immediately before / after that tax year.

Since Hong Kong applies a territorial based tax system, an individual's tax liability is not determined by residency status but rather by the source of income, i.e. all income arising in or derived from Hong Kong is taxable in Hong Kong.

6.2 Income Liable to Tax

Individuals are subject to salaries tax on all income arising in or derived from Hong Kong from any (i) directorship (ii) employment and (iii) pension.

Taxable income includes salaries and wages, director fees, leave pay, benefits in kind, the rental value or cash allowances. The extent to which the remuneration components are taxable depends on the following classification.

i. Directorship

Holding a directorship position is defined by the relevant duties and responsibilities stipulated in Hong Kong's Companies Ordinance. Director income is usually considered "office income". The source of office income is based on where the office is, i.e. where the company is located. A director of a company that is a resident in Hong Kong is therefore always subject to salaries tax. No exemptions are applicable.

ii. Employment

Employment income is usually classified as either "Hong Kong employment" or "Non-Hong Kong employment". Under Hong Kong employment, all working days are taxable in Hong Kong as the location of the employment is seen as located in Hong Kong. Under non-Hong Kong employment, only Hong Kong working days are taxable.

In order to determine the location of the employment, the IRD considers the following three aspects:

- Where the contract of employment was negotiated and entered into, and is enforceable;
- The place of residence of the employer; and
- The place of payment of the employee's remuneration.

An individual who qualifies as a visitor and spends less than 60 days in Hong Kong during a tax year can be exempt from salaries tax. Under a Hong Kong employment, foreign working days can be exempt from tax if the taxpayer can prove that these days are taxable in the other jurisdiction and tax has been paid there. Exemptions are not available automatically but need to be applied for.

iii. Pension

Pension income arising in or derived in Hong Kong is generally taxable in Hong Kong. However, pensions received from a recognized occupational retirement scheme are exempt.

Pension payments are also exempt if made upon retirement, termination of employment after 10 years or incapacity or death.

6.3 Allowable Deductions

Deductions are allowed for expenses if they are wholly, exclusively and necessarily incurred in the production of taxable income.

The following expenses are deductible for tax year 2015 / 16:

- Self education expenses (up to HKD 80,000)
- Contributions to Hong Kong's MPF (up to HKD 18,000)
- Cash donations to approved charities (above HKD 100 but not exceeding 35% of income after allowable expenses)
- Home loan interest (up to HKD 100,000)
- Elderly residential care expenses (up to HKD 80,000)

In addition, taxpayers are entitled to the following personal allowances:

- Basic allowance (HKD 120,000)
- Married person's allowance (HKD 240,000)
- Child allowance (max. 9 children) (HKD 100,000)
- Additional child allowance (year of birth) (HKD 100,000)
- Single parent allowance (HKD 120,000)
- Dependent brother / sister allowance per dependent (HKD 33,000)
- Dependent parent / grandparent allowance per dependent (HKD 20,000 – 80,000)
- Disabled dependent allowance (HKD 66,000)

6.4 Tax Rates

Salaries tax is levied on net chargeable income (assessable income less personal deductions and allowances) at progressive rates ranging from 2% to 17% (see table below) or a standard rate of 15% on assessable income less personal deductions, whichever is lowest.

Net Chargeable Income	Progressive Tax Rate in HKD
Up to HKD 40,000	2%
HKD 40,001 – HKD 80,000	7%
HKD 80,001 – HKD 120,000	12%
Above HKD 120,001	17%

6.5 Tax Compliance

The year of assessment starts on 1 April and ends on 31 March of the following calendar year.

The filing deadline for salaries tax returns is generally 1 month from the date of issue. In general the IRD issues salaries tax returns in early May of each calendar year.

Married couples usually file their own salaries tax returns but can elect for joint assessment if more beneficial.

The salaries tax is usually due in January of the calendar year following the tax year. The taxpayer has to pay his final salaries tax liability plus prepayments (provisional salaries tax) for the coming tax year. Usually the IRD accepts the total amount to be paid in two instalments.

6.6 Social Security Contributions

Where an employee is covered by the by the Mandatory Provident Fund (MPF) system, both the employer and the employee are required to contribute 5% of the employee's relevant income on a monthly basis to an MPF scheme, up to a maximum of HKD 1,500 each.

Employees earning less than HKD 7,100 per month do not need to contribute their portion but can elect to do so voluntarily.

The employee "relevant income" includes wages, salaries, leave pay, fee, commission, bonus, gratuity, perquisite or allowance.

Foreigner are exempt from the MPF scheme if they work in Hong Kong for a period of less than 13 months or if they are covered by an oversea retirement scheme.

7 Indirect Taxes

7.1 Value Added Tax / Goods and Services Tax

There are no value added tax, goods and service tax or sales tax in Hong Kong.

7.2 Customs Duty

There is no customs duty in Hong Kong.

7.3 Excise Duty

Excise duty is levied on limited categories of dutiable commodities (ie. hydrocarbon oils, spirits, tobacco, cigarettes and methyl alcohol).

7.4 Stamp Duty

Stamp duty is payable on the transfer of Hong Kong stock and the sale / lease of real property in Hong Kong.

7.4.1 Transfer of Hong Kong stock

For transfer of Hong Kong stock, stamp duty is calculated at 0.2% of the consideration or the market value, whichever is higher. Stamp duty relief is available for transfer of shares between associated corporate bodies under specified conditions.

7.4.2 Transfer of real property

a. Ad valorem stamp duty

For transfer of immovable property in Hong Kong, an ad valorem stamp duty (either at Scale 1 or Scale 2 rates) based on the sale consideration or market value of the property at the following rates:

Consideration / Value of property	Scale 1 rates[4]	Scale 2 rates[4,5]
Up to HK$2m	1.50%	HK$100
HK$2m – HK$3m	3.00%	1.50%
HK$3m – HK$4m	4.50%	2.25%
HK$4m – HK$6m	6.00%	3.00%
HK$6m – HK$20m	7.50%	3.75%
Over HK$20m	8.50%	4.24%

b. Special stamp duty (SSD)

Transfer of real property within 36 months is subject to the following additional SSD if the property was acquired on or after 27 October 2012.

Property holding period	SSD rate
Less than 6 months	20%
6 - 12 months	15%
12 – 36 months	10%

Note
4 Subject to marginal relief upon entry into each higher rate band.
5 Scale 2 rates apply to residential property acquired by a Hong Kong permanent resident who does not own any other residential property in Hong Kong at the time of acquisition and certain other limited circumstances.

c. Buyer's stamp duty (BSD)

With effect from 27 October 2012, any person other than a Hong Kong permanent resident is subject to BSD on the acquisition of Hong Kong residential properties. BSD is chargeable on 15% on the purchase consideration or market value of the property, whichever is higher.

7.4.3 Lease of real property

For lease of real property in Hong Kong, stamp duty is calculated at a specified rate of the annual rental which varies with the term of the lease. The current applicable rate ranges from 0.25% (for lease period of not more than 1 year) to 1% (for lease period of not more than 3 years).

8 Inheritance and Gift Tax

There is no inheritance and gift tax in Hong Kong.

8.1 Estate Duty

Estate duty was abolished in Hong Kong in 2006.

9 Wealth Tax

9.1 Property Tax

Property tax is levied at 15% on the rental income payable to the owners of land and / or buildings in Hong Kong.

The only allowable deductions are rates (paid by the owner), irrecoverable rent and a 20% statutory allowance for repairs and expenses.

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