

# Hong Kong Tax Update – 2008

## 17 March 2009

KC Law  
Tax Partner  
PricewaterhouseCoopers



# What Happened in 2008

---

1. The Inland Revenue Department
  - IRO, DIPN, advance rulings, tax treaties
2. Board of Review cases
3. Court Cases

# The IRD - IRO

---

1. Deduction for approved charitable donation increased to 35% (S16D, S26C)
  
2. Deduction for specified capital expenditure for environmental protection facilities (S16H, I, J, K Schedule 17)
  - definition
  - machinery – 100% deduction
  - installation – 20% for 5 years
  - recapture upon sale
  - transitional arrangement
  
3. Tax rates reduction

# The IRD – Advance Rulings

---

- Only two rulings published
- Both on source of profits

# Advanced Ruling No. 36

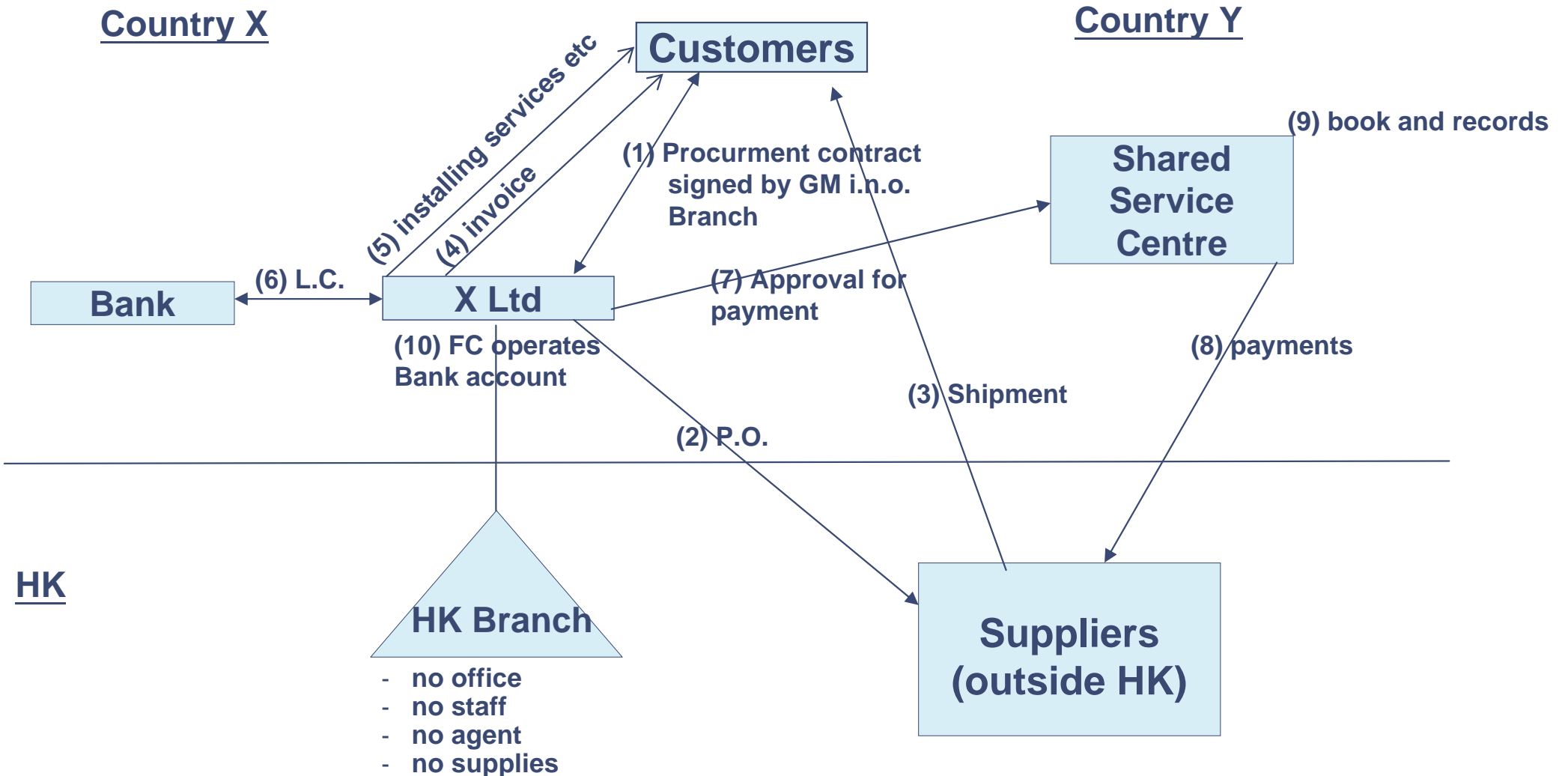
---



**Ruling: profits not chargeable**

**Reason: services are not performed in HK**

# Advanced Ruling No. 37



**Ruling:** trading profits booked in HK not taxable

- Reason:**
- no operations in Hong Kong
  - not avoidance arrangement
  - profits taxable in Country X

# The IRD - DIPNs

---

## Three DIPNs issued

- DIPN No. 3: Profits Tax – Apportionment of Expenses
- DIPN No. 38: Salaries Tax – Employee share based benefits
- DIPN No. 44: Arrangement between the Mainland of China and the HKSAR for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income

# DIPN No. 3

---

## 1. Section 16 (1)

“.... There shall be deducted all outgoings and expenses to the extent to which they are incurred in the production of profits chargeable to tax.”

### 1. Dual purpose

- onshore / offshore
- revenue / capital
- business / domestic or private

### 2. “Reasonal and Equitable” basis

### 3. IRO

- Section 16B(2), R&D expenditure
- Section 16E(2), patent rights
- Section 16G(2), prescribed fixed assets

# DIPN No. 3 (Cont'd)

---

## 5. IR Rules 2A, 2B and 2C

- Trading profits: Expenses to be apportioned based on turnover or G.P.
  
- Profits from share trading and investment:
  - Interest expenses for share investment not deductible
  - Admin and general expenses are deductible, except when management and supervision of investment portfolio activities are significant
  - Direct expenses are disallowed
  - G&A expenses, a % of the total cost of the investment portfolio is disallowed, 1/8% or 1/2%

1. How share based benefits are taxed
2. No change in assessing practice for share option
  - assessed on gain realised by the exercise, assignment or release
  - more examples on various circumstances e.g. restriction on sale, HK/non HK employment etc
3. What is new → The assessment approach on Share Award Benefits
  - two approaches: “Upfront” vs “Back End”
  - more complication on cases of non-HK employment, inbound/outbound employee
4. Administration
  - person departing permanently from Hong Kong
  - reporting requirements for employees and employers

# DIPN No. 44

---

1. 11/2/98, limited arrangement  
21/8/06, comprehensive arrangement (effective on 1/4/07 for HK,  
1/1/07 for PRC)  
11/9/07 and 30/1/08, Second Protocol (effective on 11/6/08)
  
2. The Second Protocol
  - PE: 183 days to replace 6 months
  - Gain on alienation of share of a PRC Company by a HK resident: tax in Mainland if no less than 50% of the assets consists of immovable Mainland properties within 3 years before the alienation. Book values of assets are used
  - Gain on alienation of share in a Mainland Company by a HK resident: tax in Mainland if within 12 months prior to the alienation, the HK resident once owned not less than 25% of the shareholding of the Mainland Company

# The IRD – Tax Treaties

---

1. Five treaties entered into since 1997
  - Mainland of China (1998, 2007)
  - Belgium (2004)
  - Thailand (2005)
  - Luxembourg (2008)
  - Vietnam (2008)
  
2. In the pipeline → Kuwait
  
3. The question on Eol

# The IRD – Tax Treaties (Cont'd)

## 4. Luxembourg

- Effective – Lux from 1/1/08, HK from 1/4/08
- Withholding tax

	<u>Dividend</u>	<u>Interest</u>	<u>Royalties</u>
Lux – nontreaty	15%	NIL	NIL
HK – nontreaty	NIL	NIL	4.95%
Treaty rate	0% / 10% <sup>(1)</sup>	NIL	3% <sup>(2)</sup>

(1) 0% applies when HK Co holds 10% shares or more, or acquisition costs is EUR1.2M

(2) for HK payer

- Capital gains

Exempt on disposal of shares of a Lux company except for a real property holding company where more than 50% of the asset value is Lux immovable property

# The IRD – Tax Treaties (Cont'd)

---

- Resident

Similar to other treaties

- PE for Services

180 Days within any 12 months period

- Limitation of benefit

None

# The IRD – Tax Treaties (Cont'd)

## 5. Vietnam

- Signed on 16/12/08, awaiting ratification procedures
- Withholding tax

	<u>Dividend</u>	<u>Interest</u>	<u>Royalties</u>
Vietnam – nontreaty	NIL	10%	10%
HK – nontreaty	NIL	NIL	4.95%
Treaty rate	10%	0% / 10%	7% / 10%

- Capital gains

Exempt on disposal of shares of a Vietnam company when the ownership is less than 15% and asset value is not 50% or more of Vietnam immovable property

- PE for services

180 days within 12 month period

# The IRD – Tax Treaties (Cont'd)

---

- HK companies performing business in Vietnam without a PE, Foreign Contractor Withholding Tax reduced from 10% to 5% (5% business income tax waived)
- Tax sparing provided for HK company which pays business income tax for its PE in Vietnam (10 years from effective date of DTA)

# Board of Review Cases (published)

1.	<p>Personal Assessment/Property tax</p> <ul style="list-style-type: none"><li>• Meaning of permanent/temporary resident</li><li>• Expenses deductible</li><li>• Whether assessable value includes license fees</li></ul>	<p>D5/08</p> <p>D20/08</p> <p>D48/07</p>
2.	<p>Profits tax</p> <ul style="list-style-type: none"><li>• Sale of property, capital or revenue</li><li>• Extension of time of appeal</li><li>• Source of profits</li></ul>	<p>D3/08, D13/08, D14/08, D23/08, D43/07, D44/07, D39/07</p> <p>D7/08, D19/08, D21/08, D24/08, D41/07, D50/07</p> <p>D16/08, D18/08</p>

# Board of Review Cases (published) (Cont'd)

3.	<p>Salaries tax</p> <ul style="list-style-type: none"><li>• Source of employment</li><li>• Expenses deductible</li><li>• Salary/business income</li><li>• Holiday benefit</li><li>• Share benefit</li><li>• Income assessed too high</li><li>• Gratuity or compensation for losses of office</li></ul>	<p>D1/08, D40/07</p> <p>D2/08, D11/08, D46/07, D50/07</p> <p>D4/08, D38/07</p> <p>D9/08</p> <p>D10/08</p> <p>D22/08</p> <p>D42/07</p>
4.	<p>Penalty tax</p> <ul style="list-style-type: none"><li>• Additional tax excessive</li></ul>	<p>D12/08</p>
5.	<p>Others</p> <ul style="list-style-type: none"><li>• Application for stating a case on question of law to CFI</li></ul>	<p>D45/07</p>

# Court Cases

Taxpayer	Judgement	Decision	Issue
1. Chang Hoi Yan	Magistracy on 30/7/08	Convicted and fined	False claim on DPA
2. Ip Yuet Ying	Magistracy on 18/1/08	Convicted and fined	False claim for elderly care expenses
3. Lau Siu Lung	Magistracy on 3/6/08 CFI on 29/8/08	Two months jail and fined	False claim on DPA
4. Cheng Miu Ling	Magistracy on 7/1/08	Two months jail and fined	Incorrect property tax return
5. Canton Industries Ltd [HCIA 6/2007]	CFI on 7/3/08	Taxpayer's appeal dismissed	Whether amortization of permanent quota deductible
6. Tong S L Franco [CACV 29/07]	CA on 21/2/08	Taxpayer's appeal dismissed by way of consent	Deduction for bad debt
7. Tsai G W [CACV 7/2008]	CA on 21/11/08	CIR's appeal allowed	Whether gratuity received was severance pay or long service payment

# Court Cases

Taxpayer	Judgement	Decision	Issue
8. Real Estate Investments (NT) Ltd [FACV 3/2007]	CFA on 7/1/08	Taxpayer's appeal dismissed	Profits on disposal of landed property
9. China Map Ltd and others [FACC 28, 29, 30 & 31/2007]	CFA on 16/4/08	Taxpayer's appeal dismissed	Profits on disposal of landed properties
10. Indosuez W I Carr Securities Ltd [FACA 2/2008]	CFA on 29/8/08	Consent summons	Source of brokerage commission and interest income
11. Lee Y S, Yeung Y C [FACV 14/2007]	CFA on 31/1/08	Taxpayer's appeal dismissed	Whether loss on securities/share transaction should be deductible under P.A.
12. Datatronic Ltd [CACV 275/08]	CFI on 13/6/08	CIR's appeal dismissed, CA scheduled to be heard in June 09	Onshore/offshore profits
13. Chu R Y [HCIA 7/2007]	CFI on 13/6/08	Taxpayer's appeal dismissed Taxpayer has filed an appeal to CA	Penalty for omission of income

# Court Cases (Cont'd)

Taxpayer	Judgement	Decision	Issue
14. Fuchs W.A.H. [CACV 196/08]	CFI on 26/6/08	Taxpayer's appeal partly allowed Appeal to CA to be heard in March 09	Whether lumpsum received on termination of employment assessable
15. Ngai Lik Electronics Ltd [CACV 22/2008]	CA on 15/10/08	Taxpayer's appeal dismissed Appeal to CFA to be scheduled for hearing	Section 61A
16. Shui On Credit Ltd Ltd [CACV 85/2008]	CA on 18/12/08	Taxpayer's appeal dismissed Appeal to CFA to be scheduled	Section 61A

# The way ahead

---

- source rule
- tax avoidance
- Transfer pricing
- Tax treaty network
- double taxation
- expenses deduction
- tax administration

..

..

..

..

# Thank You.

The information contained in this presentation is of a general nature only. It is not meant to be comprehensive and does not constitute legal or tax advice. PricewaterhouseCoopers Limited ("PwC") has no obligation to update the information as law and practice change. The application and impact of laws can vary widely based on the specific facts involved. Before taking any action, please ensure that you obtain advice specific to your circumstances from your usual PwC client service team or your other tax advisers.

The materials contained in this presentation were assembled on 16 March 2009 and were based on the law enforceable and information available at that time.