

HONG KONG TAX

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TAX CREDIT SYSTEM ENHANCED



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Highlights

On 26 October 2018, the Hong Kong Inland Revenue Department (IRD) announced a transitional arrangement for salaries tax in relation to double taxation relief further to the legislative amendment enacted on 13 July 2018.

Under section 8(1A)(c) of the Inland Revenue Ordinance (IRO), employment income derived from services rendered outside Hong Kong which is chargeable to foreign tax of substantially the same nature as Hong Kong salaries tax can be excluded from salaries tax if the IRD is satisfied that such foreign tax has been paid (Income Exclusion Claim). In general, taxpayers would be better off to claim exclusion under section 8(1A)(c) and hence they tend to go for it rather than claiming tax credits under the relevant comprehensive double tax agreement (CDTA).

With the legislative amendment in response to the Base Erosion and Profit Shifting action plan enacted on 13 July 2018, taxpayers rendering services in territories where Hong Kong has entered into a CDTA no longer be able to choose the Income Exclusion Claim and will be required to lodge a tax credit claim in order to be relieved from double taxation starting from the year of assessment 2018/19.

As some taxpayers have furnished or will need to furnish their 2018/19 tax returns and finalise their salaries tax assessments before the end of the year of assessment (eg those who have left or are about to leave Hong Kong), the IRD announced on 26 October 2018 that they will consider granting the Income Exclusion Claim to taxpayers who derived income from services rendered in CDTA territories, provided that their 2018/19 tax returns are received by the IRD on or before 31 December 2018.

In Details

The Inland Revenue (Amendment) (No. 6) Ordinance 2018 (the Amendment Ordinance) was enacted on 13 July 2018. Amongst other things, legislative provisions were introduced to enhance the current tax credit system and are summarised below.

1. The Amendment Ordinance statutorily provides that section 8(1A)(c) claim is only available for income derived from services rendered in territories where there is no CDTA in place with Hong Kong. For income derived from services rendered in a CDTA territory, a taxpayer will be entitled to claim tax credit under the CDTA.
2. The amount of any relief from double taxation must not exceed the relief that would be allowed had all foreign tax minimisation steps been taken. Taxpayers who seek to obtain tax relief under section 8(1A)(c) or to claim tax credit under the applicable CDTA are required to take all reasonable steps to minimise their foreign tax liabilities under the laws of the foreign territory or the CDTA concerned.
3. If the relief under section 8(1A)(c) or tax credit under CDTA is allowed to a taxpayer and subsequently such relief or credit becomes excessive as a result of an adjustment to his or her foreign tax liability, the taxpayer is required to give a written notice to the IRD within three months after adjustment is made.
4. The time period for claiming tax credit is extended from two years to six years.

The above amendments will apply in relation to tax payable for a year of assessment beginning on or after 1 April 2018 (ie year of assessment 2018/19). However, as a transitional arrangement, the IRD has announced in its website that they will consider to provide relief under section 8(1A)(c) in respect of income derived from services rendered in CDTA territories for taxpayers who have left or is about to leave Hong Kong and is required to finalise their salaries tax assessments before the end of the year of assessment 2018/19. This only applies to 2018/19 tax returns which are received by the IRD on or before 31 December 2018. In respect of 2018/19 tax returns received on or after 1 January 2019, the new requirements have to be duly observed.

Commentary

The new requirements will have impact on individual taxpayers who had relied on relief under section 8(1A)(c) to exclude the portion of their employment income relating to services rendered outside Hong Kong, such as Mainland China, in their individual tax returns. Taxpayers should exercise due care in completing their individual tax returns starting from the year of assessment 2018/19 and seek advice from tax professionals where necessary.

The requirement for taxpayers to take reasonable steps to minimise their foreign taxes means that taxpayers need to be more careful in handling their foreign tax returns. Any foreign tax paid voluntarily may not be allowed for income exclusion or tax credit claim.

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