

When is income of a Hong Kong company subject to Hong Kong tax? The relevant section in the Inland Revenue Ordinance is section 14, commonly referred to as the charging section. This section provides that:

“Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment at the standard rate 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 for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with this Part.”

The first point to note is that the place where a company was incorporated is of no relevance when it comes to determining whether a company is liable to profits tax. The initial question in such a determination is whether the person is carrying on a trade, profession or business in Hong Kong. If it is concluded that a person is indeed conducting such an activity in Hong Kong, profits tax is payable only in respect of profits that have a source located in Hong Kong. However, section 14 provides three further criteria that need to be considered:

1. the profits in question must be associated with the trade, profession or business that the person is carrying on in Hong Kong;
2. the profits in question must be revenue in nature and computed in accordance with the provisions of the Inland Revenue Ordinance, and
3. the profits must have been earned in the year of assessment in question.

Only if all these questions can be answered in the affirmative can a profit earned by a person be charged to Hong Kong profits tax.

It is important to appreciate that it is incumbent upon a taxpayer to prepare a computation of the assessable profits in accordance with the provisions of the Inland Revenue Ordinance. Such a computation should include a schedule of those profits that do not fall within the charge to profits tax. As it is the taxpayer who is making a claim for such profits to be excluded from tax, it is important that the taxpayer provide, in detail, the reasons why such profits should be excluded from taxation. Typical claims include profits that are capital in nature and those derived from a source located outside Hong Kong.

This computation must be sent to the Inland Revenue Department together with the annual profits tax return and audited statutory accounts, where appropriate. Failure to do so will constitute an incomplete return and may lead to the Inland Revenue Department raising an estimated assessment.

We strongly recommend that if a taxpayer has profits that fall outside of section 14, he/she should provide a full description of those transactions giving rise to the profits, at the time the first relevant tax computation is filed with the Inland Revenue Department.

We have observed many instances where a taxpayer files a tax return excluding profits from profits, tax without providing an explanation for doing so. This frequently leads to a detailed request for information from the Inland Revenue Department, sometimes several years later, when either the relevant documentation has been lost or filed away in storage, or people with knowledge of the transaction have left the company. All of this makes it difficult and expensive to substantiate the claim.

In later articles on the website, we'll discuss the concept of carrying on business in Hong Kong, the source of profits etc.