HONG KONG TAX ALERT

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Hong Kong - Salaries Tax Double Taxation Relief - transitional arrangements

Summary

The exemption under section 8(1A)(c) Inland Revenue Ordinance ("IRO"), generally referred to as unilateral relief, often provided greater relief from double taxation than was available via tax credit relief due to the way tax credit relief is calculated in Hong Kong.

The amendment, introduced earlier this year, limited unilateral relief to situations where tax is paid in territories with which Hong Kong does not have a Comprehensive Double Taxation Agreement ("CDTA").

Restricting the relief available will mean that some Hong Kong Salaries Tax payers will pay more tax. Of more concern, it may mean that some taxpayers, i.e., those not regarded as tax resident in Hong Kong, will not be entitled to claim any relief for double taxation in Hong Kong.

The concessionary transitional arrangement, under which taxpayers will be able to continue to claim unilateral relief regardless of the territory the services are rendered, is therefore welcomed –although, in practice, it is likely to have limited application due to the short time frame during which it is available.

We previously reported (Hong Kong Tax Alert issue 13 – July 2018) that the double taxation relief mechanism for Hong Kong Salaries Tax has been amended and that the amendment may result in some taxpayers paying more tax. Recently, the Inland Revenue Department (IRD) confirmed how the new arrangements would be applied and, on a concessionary basis, introduced a transitional arrangement for taxpayers who have left or are about to leave Hong Kong. On a concessionary basis, such taxpayers will be able to claim double taxation relief under the previous rules.

Background

On 4 July 2018, Hong Kong enacted a new transfer pricing regime. Included in the legislation was an amendment to the existing unilateral double taxation relief for Salaries Tax.

Section 8(1A)(c) IRO provides, on a unilateral basis (i.e., not subject to an agreement with the other territory), an exemption for income subject to Salaries Tax. This exemption applies when income for services rendered in another territory is subject to tax in Hong Kong and in the other territory. The exemption is intended to mitigate or eliminate the impact of double taxation of the same income. This is particularly important for Hong Kong due to the unusual basis of taxation and the interpretation of what is Hong Kong "sourced" income.

However, going forward, if double taxation arises in a territory with which Hong Kong has a CDTA, relief will have to be claimed under the CDTA. This means that, rather than claiming an exemption for the income under section 8(1A)(c) IRO, relief will be claimed under section 50 IRO by crediting the foreign tax paid against the Hong Kong Salaries Tax payable.

Although this may not appear to be a significant change, in practice it will often result in a higher effective rate of tax than was previously the case. This is because the method used to calculate the foreign tax credit relief often means that some Salaries Tax remains payable. Furthermore, some taxpayers may not be able to claim tax credit relief in Hong Kong due to their tax resident status, i.e., if they are not considered Hong Kong tax resident under the relevant CDTA. As a result of the amendment, they may be subject to actual double taxation – that is, they will pay tax in Hong Kong and in the other territory on the same income.

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Given the timing of the enactment of the legislation, there had been some uncertainty as to when the new legislation would be effective. In a recent press release, the IRD confirmed that the new requirements apply in relation to tax payable for years of assessment beginning on or after 1 April 2018 (i.e., 2018/19 and onwards). That said, the IRD appear to have considered the potentially retrospective application of the amendment and announced that they will, on a concessionary basis, accept unilateral relief claims, regardless of where the services are rendered, if submitted before 31 December 2018. This concessionary transitional arrangement is available to taxpayers who have or will need to finalise their tax affairs before the end of the 2018/19 year of assessment – i.e., taxpayers who have or will leave Hong Kong before 31 March 2019. For these cases, provided the 2018/19 tax return is received by the IRD on or before 31 December 2018, unilateral relief can be claimed regardless of the territory in which the services were rendered.

As the 2018/19 tax returns for most taxpayers are not due until after the end of the 2018/19 year of assessment, which ends on 31 March 2019, this transitional arrangement will have limited effect – and is likely only to be relevant to employees who have ceased to be employed by a Hong Kong located employer or outbound assignees from Hong Kong who have been or are in the process of being localised in the other territory.

Where this concession does not apply, the new double taxation mechanism must be applied in respect of 2018/19 tax returns received by the IRD after 31 December 2018. The IRD have stated that any 2018/19 assessments which have already been raised will not be re-opened as a result of the transitional arrangement.

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KPMG observations

The introduction of a transitional arrangement is welcomed, but it is likely to have very limited application in practice. The transitional arrangement does not address the reason the double taxation arises, nor does it consider how relief will be claimed on an ongoing basis by Hong Kong Salaries Tax payers who are not considered tax resident under the relevant CDTA.

Employers should review their mobile workforce to determine which employees are likely to be able to benefit from the concessionary transitional arrangement. They should also consider what needs to be done in respect of employees who are adversely impacted by the new amendment.

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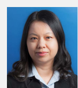

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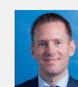

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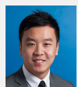

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