



# HONG KONG TAX ALERT

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## Updates in Hong Kong tax compliance matters - what you need to do

### Summary

There have been a number of changes that present many opportunities for taxpayers through various tax incentives. On the other hand, there are additional compliance requirements which, amongst other things, will mean the Inland Revenue Department ("IRD") will have access to significantly more information which taxpayers need to be conscious of.

With the looming tax compliance season for the 2018/19 year of assessment, it is a good time to reflect on the impact of the recent developments in Hong Kong tax law. There have been a number of changes that present many opportunities for taxpayers through various tax incentives. The IRD will have access to significantly more information which taxpayers need to be conscious of. Some of these tax incentives include the introduction of:

- a two-tier profits tax regime;
- an enhanced tax deduction for research and development (R&D) expenditure;
- a tax deduction for capital expenses on three types of specified intellectual property rights (IPR);
- changes to certain preferential tax regimes; and
- extending the profits tax exemption to onshore privately offered open-ended fund companies (OFC).

The most significant change to Hong Kong tax law, however, is the introduction of a transfer pricing (TP) ordinance which formally codified TP rules and the three-tiered TP documentation requirement. An important requirement under the new TP rules is that certain Hong Kong companies will be subject to country-by-country (CbC) reporting requirements even when not the ultimate parent of a reporting group.

In this alert, we summarise the impact of these changes and related administrative measures for Hong Kong corporate taxpayers:

### New Hong Kong tax returns for 2018/19

As a result of the various changes in Hong Kong tax law, new Hong Kong tax returns and supplementary forms for 2018/19 have been issued by the IRD.

For the new Hong Kong Profits Tax return (Form BIR51), several new items have been included to reflect tax-related changes under the exemption schemes and preferential tax regimes (e.g., for taxpayers carrying on a business as a professional reinsurer, an authorised captive insurer, a qualifying corporate treasury centre, a qualifying aircraft lessor or a qualifying aircraft leasing manager).

A new Hong Kong Standard Industrial Classification (“HSIC”) Code for the entity’s principal business activity has also been included in Box 4.4 of Form BIR51. Taxpayers can check their HSIC code at this website (click [here](#)) to confirm the entity’s principal business activity. However, where the entity has more than one principal business activity, the Hong Kong entity should exercise appropriate judgement to determine which is the entity’s principal business activity. The HSIC code provides the IRD with additional information to benchmark taxpayers’ income and expense patterns, and gross profit levels of the same business line.

However, the main change to the new Hong Kong Profits Tax return is the introduction of supplementary forms (Forms S1 to S10). The supplementary forms must be completed and submitted to the IRD together with the Hong Kong Profits Tax return, where applicable. The forms are categorised as follows:

Supplementary Form <sup>1</sup>	When to complete the form
<p><b>S1 Persons electing for two-tiered Profits Tax rates</b></p>	<p>Only one member of a group of connected entities can elect to be taxed under the two-tiered Profits Tax regime, whereby the first HKD2 million of profits will be taxed at half the current tax rate of 8.25% for corporations and the remainder at 16.5%.</p> <p>Taxpayers electing to be taxed under the two-tier Profits Tax regime are required to check Box 2.3 on the 2018/19 Form BIR51.</p> <p>A taxpayer is required to complete this supplementary form if it:</p> <ul style="list-style-type: none"> <li>• has positive net assessable profits;</li> <li>• elects to be chargeable at the two-tiered profits tax rates; and</li> <li>• has one or more connected entity carrying on a trade, profession or business in Hong Kong</li> </ul> <p>Where applicable, taxpayers will also be required to list all the connected entities carrying on a trade, profession or business in Hong Kong. However, this form is not required to be submitted if the entity is a member of a group of companies and one of which was listed on the Hong Kong Stock Exchange (HKEx).</p>
<p><b>S2 Transfer pricing</b></p>	<p>A taxpayer is required to complete this form if it:</p> <ul style="list-style-type: none"> <li>• has entered into transactions with related entities; and/or</li> <li>• has entered into an advance pricing arrangement; and/or</li> <li>• belongs to a MNE group which has a CbC reporting obligation (i.e., a reportable group where it had a total consolidated group revenue of at least HKD6.8 billion for the immediately preceding accounting period)</li> </ul> <p>It should be noted that submitting the supplementary form S2 does not mean that a CbC</p>

<sup>1</sup> Effective from 1 April 2019, e-fillable supplementary forms will be available for download (click [here](#))

	<p>reporting notification has been completed. The first CbC reportable period in Hong Kong is for the year ended 31 December 2018 and, as such, the first notification will be due on 31 March 2019 for that year.</p> <p>Please see below for further details on CbC reporting notification requirements.</p>
<b>S3 Expenditure on R&amp;D</b>	<p>A taxpayer is required to complete the form if it:</p> <ul style="list-style-type: none"> <li>claims a deduction for R&amp;D expenditure; or</li> <li>claims a deduction for expenditure on energy efficient building installation</li> </ul>
<b>S4 Expenditure on energy efficient building installations (EEBI)</b>	<p>A taxpayer is required to complete the form if it is eligible to claim a 100% tax write-off on capital expenditure on energy efficient building installations registered under the Hong Kong Energy Efficiency Registration Scheme for Buildings administered by the Electrical and Mechanical Services Department in the year in which the expenditure incurred.</p>
<b>S5 Ship-owner under Section 23B of IRO</b>	<p>Applies to taxpayers electing the preferential tax regimes under specific provisions of the Inland Revenue Ordinance.</p> <p>Supplementary form S5 must be submitted even if a ship owner did not earn any income from the operation of ships within Hong Kong or from voyages commencing from Hong Kong waters.</p> <p>Supplementary forms S5 to S10 must be submitted to the IRD regardless of whether a qualifying taxpayer claims any tax benefits in a given year.</p> <p>Amongst other things, the information equips the IRD to assess whether the taxpayer has complied with the substantial activities requirements under the respective preferential tax regime.</p>
<b>S6 Professional reinsurer under Section 14B(1)(a)</b>	
<b>S7 Authorised captive insurer under Section 14B(1)(b)</b>	
<b>S8 Qualifying corporate treasury centre under Section 14D(1)</b>	
<b>S9 Qualifying aircraft lessor under Section 14H(1)</b>	
<b>S10 Qualifying aircraft leasing manager under Section 14J(1)</b>	

### CbC notification requirements - When does it apply?

A CbC notification must be filed by a Hong Kong entity within a reportable group. A MNE group is a reportable group if it had a total consolidated group revenue of at least HKD6.8 billion for the immediately preceding accounting period where the MNE group's ultimate parent entity (UPE) is resident in Hong Kong. For MNE groups whose UPE is resident outside Hong Kong, the threshold amount refers to the threshold specified by the UPE's jurisdiction or, in any other case, is an amount equivalent to EUR750 million threshold as at January 2015.

A Hong Kong entity of a reportable group must file a written notice with the IRD to identify the UPE or the constituent entity responsible for filing the CbC report unless:

- It is not the Hong Kong UPE of the group, the group's surrogate parent entity (SPE) resident for tax purposes in Hong Kong nor the authorized entity to file a CbC return for the group; and
- By the notification deadline, another Hong Kong entity of the group has filed such a notice.

The CbC notification must be filed with the IRD electronically via the CbC reporting portal within 3 months after the accounting year-end date of the reportable group. It becomes applicable for accounting periods commencing from 1 January 2018. A CbC reporting account for the reporting entity must be registered on the portal before a notification can be filed electronically with the IRD.

Hong Kong entities in a MNE group should determine whether they have a CbC notification obligation as there are penalties for non-compliance.

The following table summarises both the CbC notification and CbC return filing due dates:

Year-end date	CbC notification due date	CbC return filing due date
31 December 2018	31 March 2019	31 December 2019
31 March 2019	30 June 2019	31 March 2020
30 June 2019	30 September 2019	30 June 2020
30 September 2019	31 December 2019	30 September 2020

For a detailed discussion on CbC notification and reporting filing obligations, please refer to our [Hong Kong Tax Alert 2019 – Issue 2](#).

### Accounting changes

There have also been various accounting changes which may have significant tax implications. Commencing from the 2018/19 year of assessment, HKFRS 9 (Financial instruments) and HKFRS 15 (Revenue from Contracts with Customers) will apply (with earlier adoption permitted). As such, the accounting changes for HKFRS 9 and 15 will impact the tax filings for 2018/19 year of assessment for companies and financial institutions. Taxpayers will therefore need to consider the tax impact on how certain assets and liabilities are accounted for as well as the tax implications arising from the potential mismatch between tax and accounting.

For a detailed discussion on the Hong Kong tax implications of various accounting changes, please refer to our [Hong Kong Tax Alert 2018 – Issue 9](#).

### IRD areas of focus

It is evident that the IRD is asking for more information from taxpayers through the introduction of new forms and schedules. Some of the main areas of scrutiny by the IRD include related party transactions, offshore profits claims, capital gain claims, bad debts deductions as well as challenges in the classification and timing of income and expense items in light of various accounting changes. It therefore remains critical that taxpayers maintain the necessary supporting documentation to support their claims to withstand any challenges from the IRD.

The additional administrative tax burden will impact all Hong Kong taxpayers. Taxpayers should therefore seek professional assistance to assess and review their current tax position for the upcoming tax filing season and reporting obligations.



## KPMG observations

Given the various changes in Hong Kong tax law and new disclosure requirements, there will be some complexities that Hong Kong taxpayers should be aware of and understand how this will impact them from an administrative perspective. These include:

- When preparing tax computations for tax provision purposes, Hong Kong taxpayers should look at potential areas of dispute from the IRD and obtain the necessary supporting documentation.
- Where a Hong Kong entity is part of a reportable group, there is a CbC notification requirement to notify the IRD via its CbC reporting portal. Taxpayers should commence obtaining information from their parent companies in order to prepare transfer pricing documentation requirements (such as CbC reporting) and complete the Hong Kong Profits Tax return and supplementary forms accurately.
- Ensuring that any transitional adjustments as a result of accounting changes are carefully accounted for in order to avoid a double counting of taxable income and/or deductible expenditure arising from the change in the form and timing of income and expense items.

For more information and assistance, please contact your usual tax advisor or one of our tax contacts below.



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