

GMS Flash Alert

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Hong Kong – Transfer Pricing Legislation Introduces Changes to Salaries Tax Relief

A new transfer pricing regime¹ has introduced an amendment to the existing double taxation relief mechanism for Hong Kong Salaries Tax. The amendment may have an impact on mobile employees who are subject to Salaries Tax and who render services, and are subject to tax, in territories with which Hong Kong has a comprehensive double taxation agreement (“CDTA”).

WHY THIS MATTERS

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 credits due to the way tax credit relief is calculated in Hong Kong. The removal of the ability to claim unilateral relief, which the new amendments provide for, will result in some taxpayers in Hong Kong paying more tax.

Outbound employees, i.e., employees who continue to be regarded as holding a Hong Kong located employment, from Hong Kong to a CDTA jurisdiction, will particularly be at risk of paying more tax in the year of transfer. Employees working on a commuter-type basis, travelling frequently from Hong Kong, will also be at risk of paying more tax.

Further Details

On 4 July 2018, the Legislative Council enacted Hong Kong’s new transfer pricing regime. Included in the legislation were several amendments relating to the existing unilateral double taxation relief for Salaries Tax and Profits Tax.

In respect of Salaries Tax, an amendment was made to the exemption allowed under section 8(1A)(c) IRO for income for services rendered in another territory, which is also subject to tax in that other territory. Going forward, if the double

taxation arises in a territory with which Hong Kong has a CDTA, and the taxpayer can claim tax credit relief under the CDTA, relief will have to be claimed under the CDTA.

Although this may not appear to be a significant change, in some cases this change will result in a higher effective rate of tax than was previously the case. This is because the method used to calculate the tax credit relief often means that some Salaries Tax remains payable. Some taxpayers will be subject to actual double taxation – that is, they will pay tax in Hong Kong and in the other territory on the same income.

The new legislation also introduced a number of “enhancements” to the current tax credit system:

- Extended period for claiming tax credit relief from two years to six years;
- Requiring taxpayers to reduce their foreign tax liability by making full use of all other available relief under a CDTA and local legislation in the foreign territory before resorting to tax credit relief; and
- Mandating that taxpayers notify the Inland Revenue Department of amendments to their foreign tax payments.

The amendments to the double taxation relief mechanism for Salaries Tax apply in relation to tax payable for a year of assessment beginning on or after 1 April 2018. Therefore, the new regime will have effect for the year of assessment 2018/19.

KPMG NOTE

The removal of the ability to claim unilateral relief will result in some taxpayers in Hong Kong paying more tax. Throughout the consultation process and in the paper prepared by the House Committee for the Legislative Council, the suggestion was that the changes were necessary to align domestic relief with the expectations of Hong Kong’s CDTA partners.

Employers should consider taking stock of their globally mobile workforce to determine which employees are subject to Salaries Tax and who among them could be affected the amendments.

FOOTNOTE:

1 The amendment bill (Inland Revenue (Amendment) (No. 6) Bill 2017) was published in Hong Kong’s *Official Gazette* on 29 December 2017.

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