



GMS Flash Alert

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Hong Kong – Guidance on Tax Issues Arising from COVID-19

On 29 July 2021, the Inland Revenue Department (IRD) issued guidance examining certain tax issues arising from the COVID-19 pandemic.¹ The guidance outlines the IRD's general views relating to the tax residence of companies and individuals, permanent establishment (PE), and employment income of cross-border employees, among other things.

WHY THIS MATTERS

COVID-19 has brought border closures and unprecedented disruption to the global business environment. Many companies have had to change the way in which they operate, and employees have been forced to work in locations outside their usual place of employment.

While the IRD generally adopts the views of the Organisation for Economic Co-operation and Development (OECD) to provide some certainty for taxpayers when applying a double tax agreement, unfortunately, the guidance does not offer any concession or relaxation of interpretations to accommodate these challenging situations when applying domestic tax law. Hong Kong's territorial system of taxation fundamentally requires taxpayers to determine the location where the profits are derived and profits which are foreign-sourced are not taxed in Hong Kong. Companies with an offshore profits claim may therefore find themselves in a predicament and risk such profits being challenged and regarded as Hong Kong-sourced due to their employees performing profit-generating activities in Hong Kong during the pandemic. Similarly, individuals may become taxable in Hong Kong by virtue of their physical presence here, even if caused by border closures and travel restrictions. Companies and employees should tread with caution and consult their tax advisor to carefully assess their tax positions.

Introduction

The IRD guidance outlines the IRD's general views around.

The IRD's views on and approach to tax issues relating to tax residence of companies and individuals, permanent establishment (PE), and employment income of cross-border employees are generally in line with the [Updated Guidance on Tax Treaties and the Impact of the COVID-19 Pandemic](#) (the COVID-19 Tax Treaty Guidance) and [Guidance on the Transfer Pricing Implications of the COVID-19 Pandemic](#) (the COVID-19 Transfer Pricing Guidance) released by the OECD in January 2021 and December 2020 respectively.

It is worth noting, however, the IRD guidance is not legally binding and only represents the IRD's general views. Each case will be assessed based on its own facts and circumstances. (For a detailed discussion of the OECD Secretariat's analysis of the impact of COVID-19, please see [KPMG Hong Kong Tax Alert – Issue 6](#), April 2020.)

Comments on the IRD's Views

Tax Residence of Companies

As COVID-19 continues to disrupt travel globally, this may give rise to a change in the location where senior management hold their meetings or conduct business and create concerns about a change in the tax residence status of a company. The IRD follows the OECD's view that a temporary dislocation of senior management conducting business or holding meetings in a different location during the pandemic should not have an impact on the tax residence status of a company. However, in assessing the company's residence status, the IRD will take into account all facts and circumstances and assess on a case-by-case basis.

Where there is dual residency, the tie-breaker rules under the relevant Hong Kong tax treaty would apply to determine the company's tax residence. The tie-breaker rules under the relevant Hong Kong tax treaty are unlikely to be affected if the individuals participating in the management and decision making of the company cannot travel as a result of a public health measure imposed or recommended by at least one of the governments of the jurisdictions involved.

Tax Residence of Individuals

The IRD follows the OECD's guidance that an individual's residence is unlikely to change as a result of being temporarily stranded in the host jurisdiction during the pandemic, provided that such individual does not continue to remain in that jurisdiction after the public health restrictions are lifted. Generally, individuals would unlikely become tax resident in the host jurisdiction, and even if they were, they would normally remain resident of their home jurisdiction under the tie-breaker rules in the relevant Hong Kong tax treaty.

Permanent Establishment

The IRD follows the OECD's view and considers that an employee working in a jurisdiction different from that in which they habitually work should not typically create a PE risk for their employer in that new location. Similarly, the temporary conclusion of contracts in the home of employees or agents should not create a PE unless they were already habitually concluding contracts on behalf of their employers in their home country before the pandemic.

Given the COVID-19 pandemic is temporary and extraordinary in nature, the IRD is prepared to adopt a flexible approach when determining whether a non-Hong Kong resident business has a PE in Hong Kong. The IRD will consider all the relevant facts and circumstances including the international travel disruption caused by public health measures imposed by governments in response to COVID-19. Where an individual continues to work from home after the public health measures have ceased, the IRD would examine the facts and circumstances to determine whether a PE exists.

Income from Employment

The IRD also follows the OECD's views on the application of the income from employment.

KPMG NOTE

For over 18 months, the COVID-19 pandemic has resulted in international travel restrictions being imposed by governments globally. The IRD guidance should be welcomed by many businesses as it provides a degree of reassurance for taxpayers that may have employees temporarily stranded overseas as a result of these restrictions.

Whilst it is good to see the IRD generally following the OECD's views, the guidance does not cover situations where potential tax liabilities may arise under domestic tax law due to a change in which businesses are being forced to operate or are managed or controlled during the pandemic. This is particularly relevant for cross-border workers who habitually travel overseas to perform services or conclude contracts on behalf of their employers and who are now being forced to work in Hong Kong because of the travel restrictions.

Despite the guidance, employers who have employees that are temporarily dislocated should continue to monitor their circumstances and the government travel rules regulations closely to assess whether it is really a temporarily dislocation as a result of COVID-19 or a matter of choice. In particular, care should be taken that this guidance given by the IRD only applies to the interpretation of tax treaties and the application of transfer pricing principles. The guidance does not apply to interpretation of domestic law and does not apply if the dislocation of the employee is by choice, rather than being imposed by restrictions arising from external factors. Taxpayers should tread with caution and work closely with their tax advisors to carefully assess their tax positions during the pandemic.

FOOTNOTE:

1 IRD, [*Tax Issues arising from the COVID-19 Pandemic*](#).

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