

GMS Flash Alert

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Hong Kong – Apportionment of Income for Double Taxation Relief

On 17 May 2022, Hong Kong’s Court of Appeal (“the court”) handed down its decision in *Commissioner of Inland Revenue v Lo Wa Ming Patrick* [2022] HKCA 710. The decision provides guidance on the principles and approach to be used for the apportionment of income for the purpose of double taxation relief from the Salaries Tax under section 8(1A)(c) of the Inland Revenue Ordinance. The court found the formula below to be an appropriate approach for determining the amount of income to be excluded:

$$\text{Excluded income} = \text{Income} \times [\text{outside Hong Kong}^1 \text{ working days} + \text{leave days (including rest days and holidays)} \div \text{calendar days}]$$

Notably, the court’s suggested approach is arithmetically equivalent to a “work-day” approach. In coming to its decision, the court considered different approaches including, but ultimately ruling out, the Commissioner’s initial “Day in, Day out Formula” (DIDO Formula) based on physical presence in Hong Kong and the overseas location.

WHY THIS MATTERS

Going forward, the decision will impact double taxation relief claims where double taxation has been suffered in a jurisdiction that does not have a double taxation agreement (“DTA”) with Hong Kong.² Taxpayers should retain detailed travel records including rest and leave days to support claims.

Background

- The taxpayer, Mr. Lo, was employed by a Hong Kong company. He was seconded to work in “Mainland China” (also expressed as “Mainland”) for a People’s Republic of China (“PRC”) entity between 1 August 2014 and 31 March 2015. Throughout the secondment period, Mr. Lo remained employed by the Hong Kong employer.
- During the secondment period, Mr. Lo returned to Hong Kong occasionally to perform services, which formed part of his work for the PRC entity.

- Under the terms of the secondment, Mr. Lo was entitled to paid rest days on Saturdays, Sundays and Mainland public holidays, and to annual leave, which he spent in Hong Kong for personal reasons.
- Mr. Lo's employment income during the secondment period was fully chargeable to individual income tax in Mainland China and he paid tax in the Mainland.
- Mr. Lo appealed his 2014/15 Salaries Tax assessment and sought full exemption from the Salaries Tax on his employment income during the secondment period.
- However, the Inland Revenue Department took the view that the amount of income exempted from double taxation should be determined by apportioning his income based on the number of days he spent in the Mainland each month over the total number of days in that month (the DIDO Formula). Since Mr. Lo spent time outside the Mainland, his income during the secondment was not fully exempt from Salaries Tax.
- Mr. Lo appealed to the Board of Review. The Board rejected the DIDO Formula and adopted a different formula (the Board's Formula) for determining the quantum of relief. Broadly, the Board allowed an exclusion of income based on the number of days the taxpayer did not work in Hong Kong.
- The Commissioner appealed to the Court of First Instance. However, the Court of First Instance ruled in line with the Board. The present case is the Commissioner's appeal to the Court of Appeal.

The Decision

The Court of Appeal considered four different methods of time-based apportionment to determine the amount of relief:

The Commissioner's primary position	Apportionment based on the number of days the taxpayer worked outside Hong Kong
The Board's Formula	Apportionment based on the number of days the taxpayer did not work in Hong Kong
DIDO Formula	Apportionment based on the number of days the taxpayer spent outside Hong Kong, whether working days or not
The Commissioner's alternative formula	Apportionment based on the number of days the taxpayer worked outside Hong Kong together with paid leave days attributable thereto

The court accepted the Commissioner's alternative formula, rejecting the other approaches. The court noted that, subject to contractual provisions, there is no dispute that relief should be available for income for working days worked outside Hong Kong, and not for income for working days worked in Hong Kong. The issue is the income for paid leave days. The court considered that when income accrues on leave days that is attributable to services rendered outside Hong Kong, there is no reason why such leave pay should not qualify for relief from double taxation and be excluded if other conditions in section 8(1A)(c) of the Inland Revenue Ordinance are satisfied.

The court then remitted the case back to the Board for a decision based on the below formula:

$$\text{Excluded income} = \text{Income} \times [\text{outside Hong Kong working days} + \text{leave days (including rest days and holidays) attributable to services rendered outside Hong Kong}] \div \text{calendar days}$$

The court provided a numeric example. In the relevant year, the taxpayer had 200 working days – rendering services in Hong Kong for 80 days and rendering services outside Hong Kong for 120 days – and 165 leave days. The leave days prorated to services

rendered outside Hong Kong may be calculated as $165 \times 120 \div 200 = 99$ days. The income that may qualify for exclusion under section 8(1A)(c) may be calculated as $\text{annual income} \times (120 + 99) \div 365 = 60\%$ of annual income. This is arithmetically equivalent to prorating by reference only to working days (i.e., $120 \div 200$, which is also 60%).

Whilst the above broadly refers to days rendering services outside Hong Kong, this should only include days in a territory outside Hong Kong in which the taxpayer's employment income is subject to tax.

Notwithstanding the above, the court mentioned it is a question of fact as to what income is derived from services rendered outside Hong Kong, and what leave days are attributable to services rendered outside Hong Kong.

KPMG NOTE

Subject to contractual provisions, this decision provides guidance on the approach to calculate the amount of relief from double taxation under section 8(1A)(c) of the Inland Revenue Ordinance.

Taxpayers who qualify for relief from double taxation under section 8(1A)(c) should consider whether the court's approach should be used to determine the amount of relief. Taxpayers should retain records of working days and leave days.

FOOTNOTES:

1 "Outside Hong Kong" is the territory outside Hong Kong in which the taxpayer renders services and where the taxpayer's employment income is subject to tax.

2 From the year of assessment 2018/19, double taxation incurred in a DTA jurisdiction may be alleviated through a foreign tax credit under the DTA and section 50(1) of the Inland Revenue Ordinance.

RELATED RESOURCE:

The information contained in this newsletter was adapted, with permission, from "Salaries Tax – Apportionment of Income for Double Taxation Relief," in [Hong Kong Tax Alert - Issue 9](#), June 2022, issued by the KPMG International member firm in Hong Kong.

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