

Hong Kong SAR Tax Alert

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Key tax issues discussed in the 2025 annual meeting between the IRD and the HKICPA

Summary

The minutes of the 2025 annual meeting between the Hong Kong Institute of Certified Public Accountants (HKICPA) and the Inland Revenue Department (IRD) were recently published. The minutes summarise the IRD's views on various issues related to profits tax, salaries tax, international tax and tax administrative matters.

This tax alert discusses the more important views expressed by the IRD in the meeting and our observations on those views. Taxpayers should take note of the IRD's views expressed in the minutes as they serve as a good reference of the positions taken by the IRD, though they are not legally binding.

The IRD and the HKICPA held their 2025 annual meeting in May last year to discuss and exchange views on various tax issues. The IRD's views and clarifications on the more widely applied tax issues are summarised below. For a full list of the tax issues discussed in the 2025 meeting, please refer to the meeting minutes¹.

Hong Kong profits tax issues

1. Tax deduction of lease reinstatement costs

The IRD clarified the following issues related to the tax deduction of reinstatement costs for leased premises, which applies from the year of assessment (YOA) 2024/25:

Issues	The IRD's clarifications
i. Utilisation of provision of reinstatement costs ^{Note}	<ul style="list-style-type: none"> The utilisation is deductible provided that (1) it represents actual reinstatement costs incurred or paid for reinstating the premises upon the expiry or early termination of the lease in or after the YOA 2024/25 and (2) other conditions for deduction of lease reinstatement costs are met.

Note: The provision was charged to the profit and loss account and treated as non-deductible prior to YOA 2024/25 and utilised in or after YOA 2024/25.

¹ The full meeting minutes can be accessed via this link: https://www.hkicpa.org.hk/-/media/Document/APD/TF/Tax-bulletin/036_Mar-2026.pdf

Issues	The IRD's clarifications
ii. A group holding company entered into a lease agreement with the landlord and recharged rental and reinstatement costs of the leased premises to the other group entities	<ul style="list-style-type: none"> The group entities are not regarded as the lessees and have no reinstatement obligation under the lease in question. The recharges are not deductible as lease reinstatement costs but may be deductible as intra-group service fees if the group holding company has rendered rental services to the group entities, provided that they are arm's length service fees incurred in the production of assessable profits.

2. Issuance of Hong Kong Certificates of Resident Status (HK CoRs)

The IRD expressed the following views on the issuance of HK CoRs during the meeting:

Issues	The IRD's positions
i. HK CoRs for BEPS Pillar Two purposes	<ul style="list-style-type: none"> Currently, there is no requirement under the GloBE rules for the tax residence of a constituent entity to be proved by means of a CoR. The IRD will continue to monitor the practices of other implementing jurisdictions and consider whether there is a need to issue CoRs for the Pillar Two purposes.
ii. HK CoRs for companies re-domiciled to Hong Kong	<ul style="list-style-type: none"> The existing streamlined approach that applies to Hong Kong incorporated companies is applicable to re-domiciled companies. A HK CoR issued to a re-domiciled company will cover the period starting from the date of re-domiciliation (i.e. the issuance date of the certificate of re-domiciliation). A HK CoR will only be issued to a re-domiciled company upon (1) completion of the deregistration in its original place of incorporation and (2) receipt of a proof of the deregistration by the IRD.
iii. HK CoRs for disposal gains	<ul style="list-style-type: none"> For treaty benefit claim purposes, the IRD recognises that some Hong Kong residents may have a genuine need to apply for a HK CoR before the subject income (e.g. disposal gains) arises in certain circumstances. The IRD is prepared to consider such applications if the Hong Kong residents can provide documents showing the stage of the transactions or activities giving rise to the subject income and the level of certainty that the income would arise in the relevant year. For disposal gains, such documents include the agreement for sale and purchase and memorandum of understanding, etc.

Regarding whether Hong Kong's tax treaty partners would recognise a re-domiciled company as a Hong Kong tax resident on the basis that it is "incorporated in Hong Kong" upon re-domiciliation, the IRD mentioned that (i) according to the general rule of interpretation contained in the Hong Kong tax treaties, a term which is not defined in the tax treaties has to be interpreted in accordance with the domestic laws of the relevant jurisdiction and (ii) the IRO provides that a reference to a company incorporated in Hong Kong includes a re-domiciled company.

KPMG observations:

The Articles on General Definitions in the Hong Kong tax treaties contain a clause which generally provides that "as regards the *application of the Agreement* at any time by a Contracting Party, any term not defined therein shall have the meaning that it has at that time under the applicable tax laws of *that Contracting Party*".

In the situation where a re-domiciled company (assuming it has already obtained a HK CoR issued by the IRD) is applying for a treaty benefit from a foreign treaty jurisdiction and that foreign treaty jurisdiction is assessing whether the re-domiciled company is a Hong Kong tax resident, the Contracting Party that is applying the treaty is arguably the foreign treaty jurisdiction (instead of Hong Kong). It is therefore not absolutely clear whether the foreign treaty jurisdiction will be bound by the above general rule of interpretation to regard a redomiciled company as “incorporated in Hong Kong” according to the tax laws of Hong Kong. As a secondary argument, the re-domiciled company can evaluate whether it can demonstrate that it is managed / controlled in Hong Kong.

3. Tax exemption for charitable institutions

The IRD clarified the following points regarding the tax exemption for charitable institutions under section 88 of the Inland Revenue Ordinance (IRO):

- Fund-raising activities such as selling flags or lottery tickets in a booth on street would normally not be considered as carrying on a trade. Accordingly, the profits derived from such activities do not need to rely on the tax exemption provided under section 88 of the IRO.
- A charity investing surplus cash in (i) listed shares as long-term investments or (ii) interest-bearing time deposits may not be regarded as carrying on a trade. The IRD will look into various factors (e.g. the purpose of purchasing the assets and the frequency of transactions, etc.) to determine whether investment activities carried out by a charity constitute a trade or business.

4. Interaction between the source rule and economic substance requirement (ESR) under the FSIE regime for interest income

The IRD expressed the following views in response to the concern that satisfying the ESR under the foreign-sourced income exemption (FSIE) regime would inevitably make the interest income Hong Kong sourced:

- The specified economic activities under the ESR of the FSIE regime are not necessarily the profit-generating activities under the operations test of the source rule for interest income. As such, the determination of the source of the interest income is not affected by the ESR under the FSIE regime.
- For interest income, the ESR under the FSIE regime could be satisfied where the strategic decisions related to the loan lending activities (e.g. types of borrowers and whether short-term or long-term loans should be made) are made at a meeting held in Hong Kong. Holding such meeting in Hong Kong would not undermine the offshore claim on the interest income provided that all the profit-generating activities are carried out outside Hong Kong.
- The “operations test” in the context of interest income focuses on substantive activities that put the loan in place for earning interest income, such as sourcing funds and discussing loan terms with borrowers.

KPMG observations:

Despite the above, satisfying the ESR while preserving the offshore claim for interest income under the operations test remains a delicate balancing act that requires careful consideration. It would be helpful if the IRD could provide some illustrative examples to show how the line is drawn in practice.

5. Deductibility of interest expenses

Another concern raised at the meeting was where the offshore claim of interest income is tainted by conducting certain activities in Hong Kong to fulfil the ESR under the FSIE regime such that the interest income is regarded as onshore and taxable, taxpayers may be taxed on the gross (instead of net) income when the related interest expenses are non-deductible due to the existing stringent interest expense deduction rules in Hong Kong.

In addition, the issue of tax asymmetry would arise where a Hong Kong company borrowing a loan from its overseas parent company and on-lending the loan to another group company is regarded as deriving onshore interest income under the operation test. This is because the interest income received from the group company is taxable, but the interest expenses paid to the overseas parent company is not deductible.

In response to the above, the IRD (i) acknowledged that refinement to the existing interest expense deduction rules could be explored but the possible economic impact on Hong Kong needs to be carefully evaluated and (ii) took the view that in the interim, it might be worthwhile to explore whether there are strong justifications to relax the rules for certain industries or business activities such that more targeted enhancements could be explored.

KPMG observations:

Various stakeholders (including KPMG) have been advocating for a holistic review of the existing interest expense deduction rules to ensure that the rules remain business-friendly and competitive.

6. Interaction between the FSIE regime and royalty withholding tax

There was a discussion in the meeting concerning the following situation:

- A Hong Kong taxpayer was engaged in the licensing and sublicensing of a trademark for use outside Hong Kong. The licensing and sub-licensing contracts were effected outside Hong Kong.
- The offshore royalty income was received by the taxpayer in an overseas bank account. Under the FSIE regime, the offshore royalty income will only become taxable in the year it is received in Hong Kong (the year of receipt).
- It follows that the related royalty expenses paid to the non-resident trademark owner would only become deductible in the year of receipt.

The IRD confirmed that in the above situation, the non-resident owner of the trademark would only be subject to withholding tax under section 15(1)(ba) of the IRO (and the Hong Kong taxpayer's withholding obligation would only arise) in the **year of receipt** when the royalty expenses become deductible. For ease of compliance of the withholding obligations and subject to the Hong Kong taxpayer's agreement, the IRD could explore an administrative arrangement whereby such offshore royalty income would be assessed in the year of accrual regardless of whether the income would be received in Hong Kong.

KPMG observations:

In the above situation, offering the offshore royalty income for Hong Kong taxation voluntarily in the year of accrual may not be the best approach unless it is certain that the income would be received and taxable in Hong Kong in subsequent years. Other alternatives (e.g. incorporating a clause into the licensing agreement to deal with the potential Hong Kong withholding tax exposure) can be explored instead. In some other cases, any Hong Kong withholding taxes may in any case be borne by the Hong Kong taxpayer instead of the non-resident intellectual property owners.

International tax issue

1. Country-by-country (CbC) reporting obligation in demerger cases

- In the situation where (i) a Hong Kong entity (and its subsidiaries) originally belonging to a CbC reportable group (Group A) was sold and became an independent group (Group B) in Year 1 and (ii) the Hong Kong entity became the new ultimate parent entity (UPE) of Group B, the IRD's position on Group B's CbC reporting obligation for Year 1 is as follows:

“Given Group B is a Hong Kong-headquartered group, it is required to file a CbC notification and a CbC return in Hong Kong for Year 1 if the total consolidated group revenue for the Hong Kong entity and its subsidiaries for the year immediately before the year in which the demerger occurred was not less than HK\$6.8 billion.”

- If Group B is a foreign-headquartered group, Group B's CbC reporting obligation for Year 1 depends on the requirement imposed by the UPE jurisdiction. Specifically, the IRD will not require a Hong Kong constituent entity of Group B to file a CbC report in Hong Kong if the UPE jurisdiction does not impose CbC reporting obligation on Group B for Year 1.

KPMG observations:

Hong Kong-headquartered MNE groups that were subject to CbC reporting and underwent a demerger in prior years should review their positions adopted for CbC reporting in prior years in light of the above IRD clarification. If the groups adopted an approach that is inconsistent with the IRD's position, they must notify the IRD and rectify the CbC reporting based on the IRD's approach.

Salaries tax issue

1. Reimbursement of relocation expenses

The IRD reiterated its view from the 2023 annual meeting that a reimbursement of relocation expenses incurred by the employee would be a taxable perquisite under section 9(1)(a) of the IRO and the exception under Section 9(1)(a)(iv) was not applicable as the employer was not discharging its own contractual liability. The IRD further confirmed that it was not a position to grant concession for such reimbursements or where the employer made payments to relocation vendors engaged by employees.

In the scenario where an employee concluded their Hong Kong employment and departed for a separate overseas employment and a reimbursement for the associated relocation costs were solely provided for by the overseas employment, without the requirement to render services in Hong Kong, the IRD view is that such amounts would not be subject to Salaries Tax.

In the scenario where an international assignee, holding a non-Hong Kong employment, was reimbursed for relocation expenses for returning to their home location or to another international assignment location, the IRD view is that such amounts would not be subject to Salaries Tax where derived from the home location or the new location and the employee was not required to render services in Hong Kong.

KPMG observations:

Employers with internationally mobile employees should review their relocation benefits policy and the associated tax reporting positions. Attention should be paid to mode in which relocation benefits are provided as this will have a impact on the taxation position.

Tax administrative issue

1. Completion of section 4 of the Supplementary Form S2 (Form S2)

Based on the current notes and instructions to Form S2, section 4 of the form must be completed by a Hong Kong entity if it is a constituent entity of an MNE group that met the consolidated group revenue threshold of at least EUR 750 million, or an equivalent amount, as at the accounting period end date for the immediate preceding accounting period.

For the purposes of determining whether section 4 of Form S2 needs to be completed, the IRD clarified that where an MNE group prepared its consolidated financial statements in a currency other than the Euro, the MNE group should convert the relevant amounts into Euro. The conversion should be performed by reference to the Euro foreign exchange reference rates published by the European Central Bank as of the relevant accounting period end date.

The IRD will publish the relevant information on the exchange rates on its webpage in due course. It will also refine section 4 of Form S2 to align the revenue threshold for completing the section with the revenue threshold under the GloBE rules.

2. Enhance e-filing services for individuals

In general, e-filing is available to individual taxpayers except those with more complex tax affairs. The IRD plans to further enhance individual e-filing function, subject to resource availability, to cater for more complex tax returns. For example, starting from May 2026, individual taxpayers who own a sole proprietorship business with gross income exceeding HK\$2,000,000 will be able to e-file their tax returns through the Individual Tax Portal.

KPMG observations:

The IRD has been enhancing its e-Tax platform and functionality, including the launch of new tax portals last year. We look forward to further enhancements including functions to support claims for exemption from Salaries Tax or relief from double taxation. Such enhancements will be helpful to cross-border individuals where they can file their tax return and claim exemption or relief as appropriate electronically.

If you have any questions or require assistance regarding the above developments, please feel free to contact us via taxservicesenquiry@kpmg.com.

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