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Hong Kong Profits Tax

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Profits Tax Rate : 16.5%

With effect from 2018/2019 (after 1 April 2018) Under the two-tiered profits tax rates regime, the profits tax rate for the first \$2 million of assessable profits will be lowered to **8.25%** (half of the rate specified in Schedule 8 to the Inland Revenue Ordinance (IRO)) for corporations and **7.5%** (half of the standard rate) for unincorporated businesses (mostly partnerships and sole proprietorships). Assessable profits above \$2 million will continue to be subject to the rate of 16.5% for corporations and standard rate of 15% for unincorporated businesses.

All entities with profits chargeable to Profits Tax in Hong Kong would qualify for the two-tiered profits tax rates, except those with a connected entity which is nominated to be chargeable at the two-tiered rates

If, at the end of the basis period of the entity for the relevant year of assessment, the entity has one or more connected entities, the two-tiered profits tax rates would only apply to the one which is nominated to be chargeable at the two-tiered rates. The others would not qualify for the two-tiered profits tax rates. Further, if a corporation has made an election under section 14B(2)(a) (qualifying professional reinsurance business and authorized captive insurance business), section 14D(5)(b) (qualifying corporate treasury centre), section 14H(4)(b) (qualifying aircraft lessor) or section 14J(5)(b) (qualifying aircraft leasing manager), the corporation would not qualify for the two-tiered rates.

A Simple Guide on The Territorial Source Principle of Taxation

Hong Kong adopts a territorial source principle of taxation. Only profits which have a source in Hong Kong are taxable here. Profits sourced elsewhere are not subject to Hong Kong Profits Tax. The principle itself is very clear but its application in particular cases can be, at times, contentious

Hong Kong's basis of taxation on profits from businesses

Hong Kong adopts a territorial basis for taxing profits derived from a trade, profession, or business carried on in Hong Kong. Profits Tax is only charged on profits which arise in or are derived from Hong Kong. In simple terms this means that a person who carries on a business in Hong Kong but derives profits from another place is not required to pay tax in Hong Kong on those profits.

Many places levy tax on a different basis. Unlike Hong Kong, they tax the world-wide profits of a business, including profits derived from an offshore source.

Basic principles for determining the source of profits

The Courts have over the years considered the subject of the source of profits. The following principles have emerged from authoritative court decisions -

Matter of fact

The question of locality of profits is a hard, practical matter of fact. No universal rule can apply to every scenario. Whether profits arise in or are derived from Hong Kong depends on the *nature* of the profits and of the transactions which give rise to such profits.

The operations test

The broad guiding principle is that one looks to see what the taxpayer has done to earn the profits in question and where he has done it. In other words, the proper approach is to identify the *operations* which produced the relevant profits and ascertain *where* those operations took place.

Gross profits from transactions

The distinction between Hong Kong profits and offshore profits is made by reference to the gross profits arising from individual transactions. Only those business activities which directly produce the gross profits are taken into consideration in determining the source of profits. Activities such as general administration are normally not relevant.

Place where decision is made

The place where the day-to-day investment/business decisions take place is only one factor which has to be taken into account in determining the source of profits. It is not usually the deciding factor.

Business presence overseas

A business may maintain a presence overseas which earns profits outside Hong Kong but the absence of a business presence overseas does not, of itself, mean that all the profits of a Hong Kong business invariably arise in or are derived from Hong Kong. However, in the vast majority of cases where the *principal place of business* is located in Hong Kong and there is no business presence overseas, profits earned by that business are likely to be chargeable to Profits Tax in Hong Kong.