

## **Consideration for Offshore Profits – Hong Kong Companies**

Hong Kong adopts one of the most pro-commerce tax systems in the world. Corporations are required to pay only 17.5% profits tax on their profits. There is no restriction on the loss being carried forward. There is no value added tax, capital gains tax or sales tax. In addition, there is no withholding tax on dividend and interest. Hong Kong adopts a taxation system based on the territorial principle. Only profits which arise in or derived from Hong Kong are subject to tax in Hong Kong. Income from outside Hong Kong is not subject to any form of taxation.

However, there is actually no law or regulations which govern how the Inland Revenue Department will consider whether certain profits are 'offshore' in nature. We can only draw some observations from cases which the Court has decided.

### **Trading activity**

If a company is principally engaged in trading activities in Hong Kong, Hong Kong Inland Revenue Department ("IRD") will initially presume that the profits are fully taxable. However, IRD will consider that no liability to profits tax arising

- Issuing or accepting an invoice on the basis of a contract already concluded overseas
- Absence of permanent establishment in Hong Kong
- Suppliers and customers of the company are not located in Hong Kong
- Neither the purchase nor sale contract is effected in Hong Kong

The Practice Note consider that profits derived from re-invoicing company is not taxable to Hong Kong tax if the company carries on no real trading activities in Hong Kong, but nobody can guarantee it. All relevant factors will be examined to finally determine the issue.

### **Service fees**

The services are taxable if the services which give rise to the payment of the fees are performed in Hong Kong.

### **Exemption**

According to Departmental Interpretation and Practice Note no. 21 issued by the Inland Revenue Department, there may be cases where the activities of a Hong Kong trading business are limited to the following:

- issuing or accepting an invoice (not order) to or from an ex-Hong Kong customer or supplier (whether related or not) on the basis of contracts of sale or purchase already effected by an ex-Hong Kong associate;
- arranging letters of credit;
- operating a bank account, making and receiving payments; and
- maintaining accounting records.

This situation commonly arises when a Hong Kong business, as a member of a group and pursuant to group directives, carries out the above activities and "books" the profits in Hong Kong. Provided the activities of the Hong Kong business do not include the acceptance or issue of sale or purchase orders in or from Hong Kong, the profits would not be taxable.

Under the current practice of Inland Revenue Department, the profit generated from the above operational mode is most likely not liable for Hong Kong Profits Tax. Please note that now IRD consider to revise the current practice.

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