Hong Kong: IRD shares view on certain salaries tax issues

December 10, 2019

In brief

At the 2019 annual meeting between the Hong Kong Inland Revenue Department (IRD) and the Hong Kong Institute of Certified Public Accountants (HKICPA), the IRD shared its views on two Hong Kong salaries tax issues – double tax relief for individuals and taxation of share awards.

Although the meeting minutes are not law and are not legally binding, they are a good reference of the IRD's position on the claim of double tax relief since the enactment of Section 8(1C) of the Inland Revenue Ordinance (IRO) in 2018, as well as on taxability of share awards for mobile employees. These discussions should be taken into consideration in addressing employees' salaries tax matters, especially due to an increased focus on tax compliance.

In detail

The annual IRD and HKICPA meeting was held in May 2019 and the meeting minutes recently were released. This *Insight* summarizes the two main topics discussed in the meeting. A copy of the minutes is available on the HKICPA's website.

Double taxation relief for individuals

Income exemption claims under Section 8(1A)(c) of the IRO (upon enactment of Section 8(1C)) no longer are applicable to taxpayers who render services in a territory with which Hong Kong has a comprehensive double tax arrangement (CDTA) effective from year of assessment 2018/19. Instead, a Hong Kong tax resident only can claim a tax credit in respect of foreign tax paid under Section 50 of the IRO.

A Hong Kong tax resident for the purpose of a CDTA is an individual (a) who ordinarily resides in Hong Kong (ordinarily resident); or (b) who stays in Hong Kong for more than 180 days during a year of assessment or for more than 300 days in two consecutive years of assessment, one of which is the relevant year of assessment (i.e., a temporary resident).

For a non-Hong Kong tax resident under a Hong Kong employment and rendering services in Hong Kong and a territory with which Hong Kong has a CDTA, the IRD advised that neither a Section 50 credit claim nor an income exemption claim under Section 8(1A)(c) is applicable. Instead, relief should be sought from the CDTA territory or territory where the taxpayer is a tax resident.

Nonetheless, exemption under Section 8(1A)(b)(ii) and 8(1B), where no services are rendered in Hong Kong, or where services are rendered in Hong Kong during visits not exceeding a total of 60 days in a year of assessment, continues to be available.

***PwC observation**: If an employee under a Hong Kong employment is on a long-term secondment to a CDTA territory, does not meet the definition of a Hong Kong tax resident, and renders services in Hong Kong during visits exceeding a total of 60 days during a year of assessment, the employee may be subject to double taxation, as no exemption or double tax relief is applicable in Hong Kong. Proper planning on employment structures for outbound employees, as well as actively managing their days in Hong Kong, are crucial to mitigate double taxation.*

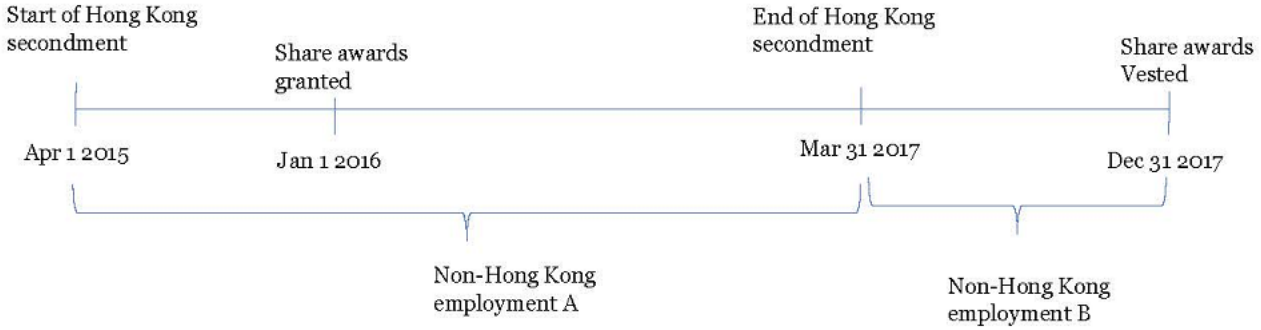
A Section 50 credit claim was not commonly used in the past because an income exemption claim under Section 8(1A)(c) was the prevailing method for claiming tax relief. Additional examples and guidance are needed from the IRD regarding credit claim cases given the increasing number of CDTAs signed between Hong Kong and other territories.

Taxation of share awards

There are two possible scenarios regarding the treatment of share awards that are vested after a Hong Kong secondment ends.

Example 1: Hong Kong secondment ends and the employer is changed

Assume a share award was granted to an employee on January 1, 2016 during his/her two-year secondment (April 1, 2015 to March 31, 2017) to Hong Kong under a non-Hong Kong employment (non-Hong Kong employment A) that was eligible for a time apportionment claim. Assume further that the share award was vested on December 31, 2017 when the employee was with another group company outside of Hong Kong (non-Hong Kong employment B). The taxpayer spent less than 60 days in Hong Kong in the year of assessment 2017/18 when the share award was vested.



The IRD takes the view that share awards are taxable perquisites that accrue to an employee at the time of vesting under Section 9(1)(a). Accordingly, taxability arises when the share award was vested on December 31, 2017. The share award was deemed to accrue on the last day of employment pursuant to Section 11D(b) proviso (ii), and therefore chargeable to salaries tax in the year of assessment 2016/17, in the year of cessation. Because the taxpayer is entitled to time apportionment, the share award chargeable in the year of assessment was calculated by reference to the following formula:

$A x (456/731) x F

- A is the value of the share award vested on December 31, 2017

- F is the time apportionment factor in 2016/17

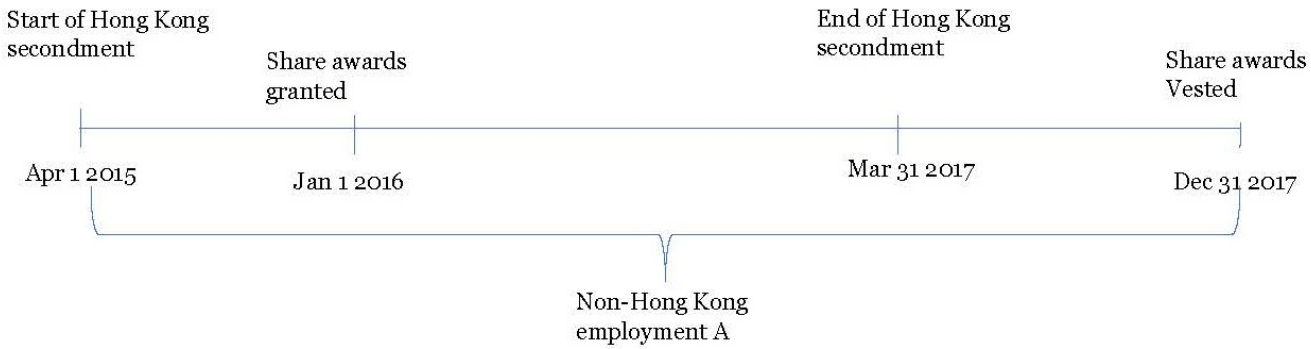
- 456 is the number of days from January 1, 2016 to March 31, 2017

- 731 is the number of days during the vesting period from January 1, 2016 to December 31, 2017.

PwC observation: *The IRD's above approach of computing the assessable share award income is consistent with DIPN 38 (revised).*

Example 2: Hong Kong secondment ends and taxpayer remains with the same employer

Similar to Example 1, except that there was no change of employment after the end of the two-year secondment in Hong Kong (i.e., the same non-Hong Kong employment continued throughout the vesting period of the share award).



Since there was no change of the employee's non-Hong Kong employment after March 31, 2017, the IRD advised that when the share award was vested on December 31, 2017 the value subject to salaries tax is calculated as follows:

$A x F

- A is the value of the share award vested on December 31, 2017

- F is the time apportionment factor in 2017/18.

Given that the employee spent less than 60 days in Hong Kong in the year of assessment 2017/18, the share award should be exempted under Section 8(1A)(b)(ii) and 8(1B) of the IRO as F is zero and therefore no part of $A is taxable in the year of assessment 2017/18.

In this case, the IRD confirmed that for a continuous employment situation, even if the employee already departed from Hong Kong, share award income would not be deemed to accrue on the last day of employment in Hong Kong.

PwC observation: *There was previously no clear guideline in DIPN 38 (revised) for the taxation of a share award granted to an employee having the same non-Hong Kong employment during and after the secondment to Hong Kong. If any employers or employees currently are adopting different methods when reporting trailing share award income similar to Example 2, they may wish to consider reviewing the reporting position.*

The takeaway

While the meeting minutes are not law and are not legally binding, employers and employees should take note of the views expressed by the IRD, review current outbound secondments to CDTA territories, and manage the assignees' travel days to Hong Kong to avoid potential double taxation due to enactment of Section 8(1C). For inbound secondments, with proper planning, employers and employees may achieve greater tax efficiency for trailing liabilities relating to share award income.

Let's talk

For a deeper discussion of how this impacts your business, please contact your Global Mobility Services engagement team or one of the following professionals:

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