Hong Kong Tax Review 2021

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HONG KONG: 2021 YEAR IN REVIEW

2021 has been another turbulent year, with the COVID-19 pandemic continuing to pose challenges to individuals and businesses alike. With governments around the world, including that of Hong Kong SAR, taking unprecedented measures to strike a balance between reviving the economy and curbing the spread of COVID-19, signs of economic recovery in different magnitudes have emerged across continents under the 'new normal'.

In the international tax context, the Organisation for Economic Co-operation and Development (OECD) has achieved significant progress in addressing the tax challenges of the digitalisation of the economy. One hundred and thirty-seven (137) jurisdictions, including Hong Kong, have agreed on a new international corporate tax framework under Base Erosion and Profit Shifting (BEPS) 2.0. As an international financial and commercial centre, Hong Kong has indicated its support to enhance tax transparency and combat tax evasion at an international level, and is expected to actively implement the BEPS 2.0 proposals.

To comply with international tax standards and move towards the e-filing era, the Hong Kong SAR Government (the HKSAR Government) has invested significant resources to accelerate the digital transformation of the tax administration in Hong Kong. Meanwhile, Hong Kong has further refined the regulatory environment and tax system to enhance Hong Kong's competitiveness. The key legislative measures enacted in 2021 include (i) enhancing the statutory framework for furnishing of tax returns, (ii) tax concessions for carried interest, (iii) a re-domiciliation mechanism for foreign funds, (iv) revised foreign tax deduction rules and (v) codified tax treatments for court-free amalgamations.

THE IRD'S ETAX JOURNEY

Currently, only a small number of profits tax returns can be furnished electronically through the Inland Revenue Department's (IRD) eTax Portal. Taking forward the OECD's recommendation in the 2019 peer review report on exchange of information upon request involves the collection and processing of electronic accounting and financial data, which necessitates the full adoption of e-filing of profits tax returns in Hong Kong.

The Inland Revenue (Amendment) (Miscellaneous Provisions) Ordinance 2021 (the Miscellaneous Provisions Ordinance) gazetted on 11 June 2021 enhances the statutory framework for furnishing of tax returns and, as part of the IRD's plan to enhance taxpayer services and operational efficiency, paves the way for e-filing of profits tax returns.

The IRD's plan and timeline on e-filing of profits tax return are as follows:

- the first phase is to enhance the existing eTax Portal by to enable more businesses to voluntarily e-file profits tax returns together with their financial statements and tax computations in inline eXtensible Business Reporting Language (iXBRL) format in a pilot run by April 2023 (with a test run in December 2022);
- the second phase is to develop a new Business Tax Portal for mandatory e-filing by multinational enterprises by 2025; and
- the ultimate goal is to achieve full-scale implementation of mandatory e-filing by 2030.

The IRD proposed to provide various kinds of support in order for businesses to cope with the implementation and transition, which includes provision of free conversion tools, simplified tagging requirement, provision of an online booking system for one-on-one direct assistance, etc.

FUNDS

As announced in the 2020-21 Budget in February 2020, a tax concession for carried interest distributed by private equity funds operating in Hong Kong would be introduced. The Inland Revenue (Amendment) (Tax Concessions for Carried Interest) Ordinance 2021 was gazetted on 7 May 2021, which provides a 0% profits tax rate on eligible carried interest and excludes 100% of eligible carried interest from employment income for the calculation of salaries tax applying with retrospective effect on or after 1 April 2020, and expands the eligible classes of assets that may be held and administered by a special purpose entity on behalf of a fund that owns the entity for the purposes of profits tax exemption for funds with effect from 7 May 2021. This should further boost the competitiveness of Hong Kong as a regional investment fund hub.

In addition, the Securities and Futures (Amendment) Ordinance 2021 and the Limited Partnership Fund and Business Registration Legislation (Amendment) Ordinance 2021 were gazetted on 8 October 2021, which introduce mechanisms for funds set up outside Hong Kong to re-domicile to Hong Kong as open-ended fund companies (OFCs) under the Securities and Future Ordinance and as limited partnership funds (LPFs) under the Limited Partnership Fund Ordinance respectively with effect from 1 November 2021.

CHANGES IN LAW ON FOREIGN TAX DEDUCTION

The Miscellaneous Provisions Ordinance gazetted on 11 June 2021 also introduces the revised rules for foreign tax deduction with effect from the year of assessment 2021/22. The revised rules for foreign tax deduction provide unilateral relief for foreign taxes on gross income imposed by jurisdictions that do not have a comprehensive double tax agreement with Hong Kong. The revised rules for foreign tax deduction should be conducive to developing Hong Kong as an intellectual property or a service hub in the region.

CODIFIED TAX TREATMENTS FOR COURT-FREE AMALGAMATIONS AND TRANSFER OF ASSETS WITHOUT SALE

Court-free amalgamations

The new Companies Ordinance (Cap. 622) came into effect on 3 March 2014 and introduced a court-free procedure for corporate amalgamations in Hong Kong.
As there was no specific provision in the then prevailing Inland Revenue Ordinance (IRO) that addressed the tax issues arising from court-free amalgamations, the IRD has been handling such cases based on an interim assessment practice published on its website.

To provide taxpayers with clarity and certainty, the Miscellaneous Provisions Ordinance gazetted on 11 June 2021 also formally introduces a statutory tax framework for court-free amalgamations in Hong Kong and codifies the IRD's interim assessing practice into the IRO to a large extent with some differences.

Transfer of assets without sale

Another part of the Miscellaneous Provisions Ordinance specifies the tax treatments for transfer or succession of various assets without sale (such as machinery or plant, commercial or industrial buildings or structures, specified intellectual property rights, prescribed fixed assets, etc.).

HONG KONG ADDED TO EU 'GREYLIST'

On 5 October 2021, the Council of the European Union (EU) added various jurisdictions, including Hong Kong, to Annex II to the Council conclusions on the revised EU list of non-cooperative jurisdictions for tax purposes, commonly known as the 'greylist' or 'watchlist', following a review of their foreign source income exemption regimes.

The updates were in part prompted by the review of foreign source income exemption regimes by the Code of Conduct Group (COCG), based on an approach where passive foreign source income that is fully exempt without clear conditions is considered harmful. Accordingly, one remedial option, if the passive income exemption is to be retained, is to implement adequate substance requirements to the entities concerned and have robust anti-abuse rules in place.

The HKSAR Government has committed to amend Hong Kong's tax system by 31 December 2022 with the amended system expected to take effect on 1 January 2023 with no grandfathering arrangement, in order to be removed from the greylist and avoid being moved to the blacklist. The HKSAR Government is working closely with the EU to come up with mutually agreeable proposals to address the EU's concerns about Hong Kong's territorial basis of taxation.

HONG KONG'S RESPONSES TO BEPS

As follow-up work on Action 1 of the BEPS Action Plan on addressing the tax challenges of the digital economy, 137 out of 141 members of the OECD Inclusive Framework on BEPS (IF) have agreed on a new international corporate tax framework comprising a two-pillar solution under BEPS 2.0. Hong Kong is one of the IF jurisdictions participating in the agreement.

The HKSAR Government formed the Advisory Panel on BEPS 2.0 (Advisory Panel) in June 2020 to assess the possible impact of BEPS 2.0 on Hong Kong's competitiveness and consider the strategies and measures in response. Taking into account the preliminary views of the Advisory Panel, the HKSAR Government has set out the following four directions of its response measures:

- To actively implement the BEPS 2.0 proposals according to international consensus;
- To minimise the impact on local small and medium-sized enterprises where possible and strive to maintain the simplicity, certainty and fairness of the Hong Kong tax regime;
- Tominimise the compliance burden on affected corporations while safeguarding Hong Kong's taxing rights; and
- To keep up the efforts in improving Hong Kong's business environment and enhancing Hong Kong's competitiveness, with a view to attracting multinational corporations to invest and operate in Hong Kong.

On 12 October 2020, the OECD released its reports on the blueprints of the two-pillar approach to address the BEPS challenges. As we understand it, the Advisory Panel has submitted a report to the Financial Secretary in December 2021, the details of which are yet to be revealed. With the BEPS 2.0 Pillar Two model rules having been released on 20 December 2021, we expect the HKSAR Government to provide more details of its implementation plan in early 2022.

LATEST STATUS OF HONG KONG TAX TREATY NETWORK

In July 2021, the comprehensive double tax arrangement between Hong Kong and Georgia entered into force.

There were no comprehensive double tax agreements signed in 2021. Hong Kong is expected to continue expanding its treaty network in 2022. Potential treaty partners include Cyprus, Lithuania, Maldives, Nigeria, Norway and Ukraine. The first round of negotiation of Hong Kong with Ukraine was completed on 16 July 2021, while the second round of negotiations with Nigeria and Cyprus were completed on 8 July 2021 and 3 December 2021 respectively.

Jurisdiction	Date of signing	Date of entry into force	Effective date in Hong Kong (year of assessment)	Effective date in the other contracting jurisdiction
Georgia	(a) 15 September 2020 (in Georgia) (b) 5 October 2020 (in Hong Kong)	1 July 2021	2022/23	1 January 2022

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