
Chapter 1

INTRODUCTION TO HONG KONG REVENUE LAW

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INTRODUCTION TO HONG KONG REVENUE LAW

¶1-0500] Scope of this chapter

This introductory chapter provides a brief overview of Hong Kong taxation and stamp duty laws. First, the context of the laws is examined. The laws which are applicable in the Hong Kong Special Administrative Region are discussed in ¶1-0700. Then, the two main pieces of revenue legislation are introduced:

- the *Inland Revenue Ordinance* (Cap 112) at ¶1-1500; and
- the *Stamp Duty Ordinance* (Cap 117) at ¶1-4500.

¶1-0700] Hong Kong Special Administrative Region

On 1 July 1997 the British Government relinquished control over Hong Kong and the territory became a Special Administrative Region (SAR) of China. The *Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China* states that under the principle of “one country, two systems” the socialist system and policies will not be practised in the Hong Kong Special Administrative Region (HKSAR). The *Basic Law* also prescribes the systems to be practised in the HKSAR.

The general principles set out in the *Basic Law* include:

- the authorisation of the HKSAR to exercise a high degree of autonomy and to enjoy executive, legislative and independent judicial power, including the right of final adjudication (Chapter 1, Art 2); and
- the guarantee that the laws previously in force in Hong Kong, including the common law, the rules of equity, Ordinances, subordinate legislation and customary law shall be maintained, except for any that contravene the *Basic Law*, and subject to amendment by the legislature of the HKSAR (Chapter 1, Art 8).

¶1-0900] Applicable laws

Having regard to the provisions of the *Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China*, the following laws are applicable in Hong Kong:

- Ordinances and subsidiary legislation enacted before 1 July 1997 (to the extent that they do not contravene the *Basic Law*, and subject to amendment by the legislature of the HKSAR);
- Ordinances enacted by the legislature of the HKSAR;

- decisions of the Hong Kong courts; and
- British common law and the rules of equity.

In August 1997, the Inland Revenue Department issued Departmental Interpretation and Practice Notes (“DIPN”) No 29: Tax Relations Between the Hong Kong Special Administrative Region and the People’s Republic of China to provide a general overview of the relationship between the HKSAR and Mainland Chinese tax environments. DIPN No 29 summarises the administrative arrangement for the HKSAR Government under the principle of “one country, two systems”. It highlights the following Articles from the *Basic Law*:

- Art 5 Hong Kong’s social and economic systems will remain unchanged for 50 years.
- Art 8 The laws previously in force in Hong Kong will be maintained.
- Art 73 The Legislative Council of the HKSAR will have the power to approve taxation policies.
- Art 106 The Central People’s Government will not levy taxes in the HKSAR.
- Art 107 The HKSAR shall follow the principle of keeping expenditure within the limits of revenues in drawing up its budget, and strive to achieve a fiscal balance, avoid deficits and keep the budget commensurate with the growth rate of its gross domestic product.
- Art 108 The HKSAR will practise an independent taxation system.
The HKSAR, taking the low tax policy previously pursued in Hong Kong as a reference, will enact laws on its own concerning types of taxes, tax rates, tax reductions, allowances and exemptions, and other matters of taxation.
- Art 116 Hong Kong will remain a free port and a separate customs territory.
- Arts 151 Hong Kong will be able to continue to establish mutually beneficial economic relations with other countries.

Conclusion and implementation of tax treaties

None of the tax treaties which the Chinese Government has signed with other countries are applicable to Hong Kong because the taxes mentioned in the treaties refer to those of the Mainland only.

In agreement with the essence of Art 151 of the *Basic Law*, the HKSAR may conclude and implement tax treaties using the name “Hong Kong, China”.

For more on tax treaties see ¶8-5000.

Hong Kong and the Mainland of China entered into a limited scope double tax arrangement in February 1998. A comprehensive arrangement for the avoidance of double taxation was entered into in August 2006 to replace the limited scope arrangement. See ¶8-6500.

Tax status of investment into and income obtained from Mainland by HKSAR residents

Following the return of Hong Kong to Chinese sovereignty, policies applicable to foreign companies, enterprises, economic organisations and foreign nationals are still applicable to investment in and income obtained from Mainland China by Hong Kong residents. The Central People's Government will continue to encourage Hong Kong residents to invest in the Mainland. Those who voluntarily fulfil their tax obligations in accordance with the related laws and regulations can continue to enjoy the tax privileges applicable to foreign investors.

Pursuant to Art 116 of the *Basic Law*, "The HKSAR shall be a separate customs territory". That is to say, imports from Hong Kong to the Mainland will still be charged with (or exempted from) custom duties, value-added tax and consumption tax in accordance with the tax laws concerned. Exports from the Mainland to Hong Kong may be entitled to refunds (or exemptions) in accordance with the related regulations.

Ordinances enacted before 1 July 1997

The *Basic Law* guarantees that Ordinances and subsidiary legislation enacted in Hong Kong by the Legislative Council before 1 July 1997 continue to apply in the HKSAR. This is subject to the qualifications that the laws must not contradict the *Basic Law* and are subject to amendment or repeal by the legislature of the HKSAR.

Local courts

The Court of First Instance of Hong Kong is bound to follow the previous decisions of the Court of Appeal of Hong Kong. The Court of Appeal is also bound to follow its own previous decisions. However, a Court of Appeal consisting of five or more judges may overrule an earlier decision of the Court sitting with less than five judges if it is satisfied that the law applied in the earlier case was wrong or that it conflicted with a previous Court of Appeal decision.

Final appeals from Hong Kong cases must go to the HKSAR Court of Final Appeal. Appeals to the Privy Council were abolished with effect from 1 July 1997.

Common law and rules of equity

Although formal legal ties with Britain no longer exist, Hong Kong continues to follow a common law system. This is guaranteed under the terms of the *Basic Law*. Decisions of the Privy Council, the House of

Lords, and other courts of common law jurisdictions are not binding in Hong Kong, but may be persuasive, depending upon the circumstances.

Expressions employed in British legislation and authorities on the meaning of such expressions may be of assistance in construing identical expressions in Hong Kong legislation which is concerned with the same subject matter (*Glynn v The Commissioner of Inland Revenue* (PC) (1990) 1 HKRC ¶90-032).

INLAND REVENUE ORDINANCE

¶1-1500 Overview of tax system

The tax structure of Hong Kong is relatively straightforward compared with some of the more complex systems which operate in other countries. Case law in the Hong Kong taxation field is not extensive. This is a direct result of the low tax rate, as the costs associated with challenging a decision of the revenue authorities may outweigh the potential monetary gain.

Direct or primary taxation is levied under the *Inland Revenue Ordinance* (Cap 112). The Ordinance is administered by the Commissioner of Inland Revenue.

There are three distinct and separate headings under which tax is levied: property tax, salaries tax, and profits tax. Income derived from Hong Kong may be liable to taxation under more than one of these headings, but where this occurs an exemption is available to alleviate the burden of double taxation (see ¶5-7200 and ¶5-7600). It should also be noted that the ambit of the Ordinance is limited territorially, and it is only income with a Hong Kong source which, by and large, is subject to tax.

¶1-1700 Property tax

Property tax is levied on the owners of real estate which is situated in Hong Kong, at the standard tax rate. The Ordinance acknowledges that a building and the land upon which it is constructed may be owned separately and, in these circumstances, separate assessments are made for each (see ¶5-1000). Liability for property tax arises by virtue of ownership and is calculated by reference to the “net assessable value” formula (see ¶5-3000).

The formula provides that the assessable value is the total consideration in money or money’s worth actually payable to the owner for the right to use the property. In arriving at the net assessable value of a property, a deduction is allowed for:

- bad debts in the year in which they become irrecoverable (see ¶5-3600);
- rates where paid by the owner (see ¶5-5000); and

- repairs and outgoings equivalent to 20% of the assessable value (see ¶5-5200).

For more on property tax, refer to Chapter 5 (¶5-0100ff).

¶1-1900 Salaries tax

Individuals are charged to salaries tax on any income with a Hong Kong source which has been obtained from an office, employment or pension (see ¶2-0050). Only income arising from within Hong Kong is taxable (see ¶2-3000). In certain situations, no tax is levied on remuneration for services performed outside Hong Kong (Government employees are taxed irrespective of where their services are rendered). Even though services are rendered in Hong Kong, an employee may not be subject to salaries tax if the period spent in the territory during visit does not exceed a total of 60 days during each year of assessment (see ¶2-3700).

Income from an “office or employment” is defined to include “wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite” and all allowances. In addition, the following items are included within the definition of income and are taxable:

- any gain which is realised by the exercise, assignment or release of share options obtained by a person as an employee or office holder of a company;
- the “rental value” of any accommodation provided rent free by an employer (or an associated company) (see ¶2-0300).

Exemptions from salaries tax

Certain categories of income are excluded from salaries tax. They are listed at ¶2-0800 and include payments from recognised occupational retirement schemes, amounts from scholarships or other educational endowments and amounts received by way of alimony.

Calculation of net chargeable income

Salaries tax is determined on a sliding scale according to the taxpayer’s “net chargeable income”. This is calculated by taking the taxpayer’s total aggregate income and first deducting the following to arrive at the taxpayer’s “net assessable income”:

- Outgoings and expenses “wholly, exclusively and necessarily incurred in the production of assessable income” (see ¶2-4950ff). Certain expenditures are not deductible, for example:
 - (i) Expenses of a domestic or private nature;
 - (ii) Capital expenditure.
- Depreciation and other capital allowances granted for plant or machinery, as prescribed by the Ordinance (see ¶2-6100).
- The taxpayer’s losses brought forward (see below and ¶2-6150).

- Deduction of self-education expenses (see ¶2-5300);
- Add the amount of any “balancing charges” arising from the sale or other disposal of plant or machinery used in the production of assessable income (see ¶2-6200).

Having deducted the above items from the total aggregate income, further adjustments are required in order to determine “net chargeable income” on which tax is ultimately charged:

- Deduct the aggregate amount of concessionary deductions available under Pt 4A of the Ordinance. Such deductions are available for: charitable donations (see ¶2-6450); elderly residential care expenses (see ¶2-6550); home loan interest (see ¶2-6700); contributions to recognised retirement schemes (see ¶2-6900); premiums paid under voluntary health insurance scheme policy (see ¶2-7000); qualifying annuity premiums and tax deductible MPF voluntary contributions (see ¶2-7010ff); and domestic rents (see ¶2-7040).
- Deduct personal allowances (see ¶2-7050).

Treatment of losses

Since expenses and allowances may exceed income subject to salaries tax, the Ordinance provides that losses incurred in gaining or producing assessable income may be carried forward indefinitely. Losses are offset against the income for the year immediately following the year in which the loss is sustained and this procedure is followed each year until all available losses have been offset (see ¶2-6150).

For more on salaries tax, refer to Chapter 2 (¶2-0050ff).

[¶1-2100] Profits tax

Individuals, corporations, partnerships and all unincorporated business ventures carrying on a trade, profession or business in Hong Kong are subject to profits tax on profits which are generated from sources within the territory (see ¶6-0030). In determining the liability to profits tax, assessable profits or losses, as the case may be, are aggregated to determine the total loss or profit.

“Carrying on a trade, profession or business ...”

Only profits arising from the *carrying on* of a “trade, profession or business” in Hong Kong are subject to profits tax. It follows that if profits are derived from Hong Kong in circumstances where the taxpayer does not carry on a business in the territory, they are not taxable.

See further ¶6-1550.

Revenue versus capital receipts

Profits tax is levied only on “revenue profits” and not income of a capital nature. There is no capital gains tax. As a general rule, the commonly

accepted accounting principles would be applied in drawing a distinction between revenue and capital receipts but in many cases it is an extremely thin line and there are no one-size-fits-all rules.

See further ¶6-3440.

Profits “arising in or derived from Hong Kong”

Only profits which arise in Hong Kong, or are derived from Hong Kong, are subject to profits tax. In some situations, it is a question of some difficulty to determine the source of profits. The guiding principle which currently applies is that “one looks to see what the taxpayer has done to earn the profit in question and where he has done it”.

This principle originated in *Commissioner of Inland Revenue v Hang Seng Bank Limited* (1990) 1 HKRC ¶90-044 and has expanded in *Commissioner of Inland Revenue v HK-TVB International Limited* (1992) 1 HKRC ¶90-064 is that “one was to ascertain what were the operations which produced the relevant profits and where those operations took place”. This approach was taken in the case of *Commissioner of Inland Revenue v Orion Caribbean Limited (in voluntary liquidation)* (1997) HKRC ¶90-089 and the case of *ING Baring Securities (Hong Kong) Limited (formerly known as Baring Securities (Hong Kong) Limited and presently known as Macquarie Securities Limited) v Commissioner of Inland Revenue* (2007) HKRC ¶90-195.

See further ¶6-1700ff.

Certain categories of income are, for the purposes of the Ordinance, deemed to have been derived from a trade, profession or business carried on in Hong Kong (see ¶6-2200).

Deductions

Expenses and outgoings, to the extent that they are incurred in producing assessable income, and are not of a capital nature, are deductible for the purpose of arriving at the net profit which is subject to profits tax. Deductions are also available in relation to payments to recognised retirement schemes, donations to charities and amounts spent on research and development.

See further ¶6-4600ff.

Depreciation and other capital allowances

Capital expenditure is not deductible from a taxpayer’s profits for tax assessment purposes. Instead, capital allowances are granted to eligible taxpayers.

Capital allowances are available for industrial buildings and structures (see ¶7-0300); commercial buildings or structures (see ¶7-1200); and for plant and machinery (see ¶7-2600) used in the production of assessable profits. Allowances are available for initial capital expenditure and for annual depreciation by wear and tear.

For more on capital allowances, refer to Chapter 7 (¶7-0100ff).

There are also provisions for deduction of building refurbishment expenses and capital expenditure on prescribed fixed assets. Refer to Chapter 6 (¶6-0030ff) for more details.

Special classes of taxpayers

The circumstances of certain classes of taxpayers demand alternative profits tax assessment methods. The *Inland Revenue Ordinance* (Cap 112) makes special provision for the computation of the profits of:

- partnerships;
- insurance corporations;
- ship owners;
- aircraft owners;
- clubs and trading associations.

Special provision is also made for the assessment of non-residents. See ¶6-7100ff.

Court-free company amalgamations

The *Companies Ordinance* (Cap. 622) which became effective on 3 March 2014 has introduced an amalgamation regime that provides a simpler and less costly method for intra-group mergers without the involvement of a court. Under the regime, two or more companies may amalgamate and continue as one, assuming the assets, rights, liabilities and obligations of the amalgamation companies. The tax treatments relating to court-free amalgamation were thus far based on the administrative practices of the Inland Revenue Department. The *Inland Revenue (Amendment) (Miscellaneous Provisions) Bill 2021* was gazetted on 19 March 2021 to largely codify those interim assessing practices, and was passed by the Legislative Council on 2 June 2021. For more on profits tax consequences of court-free company amalgamation, see ¶6-9140.

Two-tier profits tax rates regime

The *Inland Revenue (Amendment) (No. 3) Ordinance 2018*, which became effective on 29 March 2018 implements the two-tiered profits tax rates regime announced by the Chief Executive in her maiden 2017 Policy Address. The tax rates for the first \$2,000,000 of assessable profits of corporations and unincorporated businesses will be taxed at 8.25% and 7.5% respectively, and the remaining amount will be subject to the normal rates (16.5% and 15% respectively). The new regime will significantly reduce the tax burden of most taxpaying small and medium-sized enterprises. See ¶6-9100.

¶1-2300 Interest tax

The interest tax provisions were repealed by the *Inland Revenue (Amendment) (No 2) Ordinance 1989*, effective from the year of assessment commencing on 1 April 1989.

Recipients of income representing interest “arising in or derived from Hong Kong on a debenture, mortgage, bill of sale, deposit, loan, advance”, etc (including the interest component of an annuity) were formerly subject to interest tax at the standard rate on the amount of interest received or credited to their accounts.

Sums earned as interest by corporations, financial institutions and certain individuals who carry on business in Hong Kong are liable to profits tax in certain circumstances (see ¶6-2380, ¶6-2420 and ¶6-2460).

¶1-2500 Provisional tax

Any taxpayer chargeable to property tax, salaries tax or profits tax, is liable to pay provisional tax. The amount of provisional tax payable is calculated by reference to the taxpayer’s net chargeable income, assessable profits or, in the case of provisional property tax, the net assessable value of his or her property, in the preceding year.

For more on provisional tax, refer to Chapter 9 (¶9-8000ff).

¶1-2700 Personal assessment

Although taxation in Hong Kong is levied under three distinct and separate headings, an individual who is either a temporary resident or ordinarily resides in Hong Kong may elect for “personal assessment” (see ¶4-0200). When a taxpayer elects to be assessed under personal assessment, his or her total income (i.e. from employment, property and business) is subject to a sliding scale of taxes.

Apart from the advantages of the graduated scale of taxation which applies under personal assessment, the taxpayer will be able to claim personal allowances which may not otherwise be available. For example, a taxpayer in receipt of income subject only to profits tax will not be entitled to claim these family allowances if he or she does not elect for personal assessment.

Calculation of “total income”

The taxpayer’s “total income” is calculated by aggregating:

- net assessable value subject to property tax;
- net assessable income subject to salaries tax; and
- assessable profits liable to profits tax (see 4-3500ff).

Deductions are available for the following items:

- *Concessionary deductions.* Prescribed under Pt 4A of the Ordinance, deductions are available for: charitable donations (see ¶2-6450); elderly residential care expenses (see ¶2-6550); home loan interest (see ¶2-6700); and contributions to recognized retirement schemes (see ¶2-6900). With effect from the year of assessment 2019/20, deductions are also available for: health insurance premiums (see ¶2-7000); qualifying annuity premiums (see ¶2-7020); and tax deductible MPF voluntary contributions (see ¶2-7030). From the year of assessment 2022/23 onwards, further deduction is available for domestic rents (see ¶2-7040).

For details of the scope of deductions available refer to the paragraphs indicated in Chapter 2.

- *Interest.* Interest payable on money borrowed for the purpose of producing income subject to property tax, provided that the amount of such interest has not been allowed as a deduction under profits tax (see ¶4-5000).
- *Losses.* Any loss or share of a loss incurred in the course of carrying on any trade, business or profession is deductible. To the extent that losses exceed the taxpayer's total income, the amount of the loss may be carried forward and set off against income in future years (see ¶4-5500).
- *Allowances.* A taxpayer making an election for personal assessment is entitled to various personal allowances (see ¶4-6500).

For more on personal assessment, refer to Chapter 4 (¶4-0200ff).

[¶1-2900] Assessment

Assessment by the Inland Revenue Department is normally made on the basis of the information supplied by the taxpayer in his or her tax return (see ¶9-6200). When a person fails to furnish a return, or the return which is submitted is not accepted by the Inland Revenue Department for any reason, an assessor has the power to estimate the amount of tax payable and to issue an assessment accordingly (see ¶9-6300).

After an assessment has been made, a notice of assessment will be issued to the taxpayer stating the amount upon which tax has been assessed, the amount of tax payable and the date by which it must be paid (see ¶9-6800).

The Inland Revenue Department is empowered within a period of six years after the end of that year of assessment:

- to raise a new assessment against any person who is liable to tax and who has not been previously assessed; or

- to review an earlier assessment by way of an additional assessment where it appears that less than the proper amount of tax has been paid.

If fraud or wilful evasion are alleged, the review period is extended to 10 years (see ¶9-6400).

Finality of assessments

An assessment is final and conclusive as against the taxpayer in respect of the amount of assessable income or profits if:

- no valid objection or appeal has been lodged within the prescribed time period (see ¶1-3500);
- an appeal has been withdrawn or dismissed;
- an agreement is reached between the Commissioner and a taxpayer who has lodged an objection as to the amount of tax payable; or
- the assessable profits have been determined following the lodging of an objection or an appeal to the Board of Review or the courts (see ¶9-7100 and ¶11-7000).

An assessor may make an assessment or raise an additional assessment for any year provided it does not involve any matter which has been finally determined on objection or appeal. The finality of an assessment is also subject to the Inland Revenue Department's power to correct errors, omissions or arithmetical calculations which reduce the amount of tax payable, upon receipt of an application from a taxpayer within six years of the end of the relevant tax year, or six months from the date of service of the notice of assessment, whichever is the later.

For more on assessment to tax, see ¶9-5500ff.

[¶1-3100] Administrative provisions

Reporting requirements

There are many situations in which a taxpayer is under an obligation to supply information to the Commissioner, including:

- upon cessation of business or change of address (see ¶9-1100); and
- upon the taxpayer's departure from Hong Kong for a period in excess of one month (see ¶9-1100).

Employers are also required to furnish information regarding employees (see ¶9-3000ff).

Preservation of business records

A taxpayer must retain all records relating to any trade, profession or business carried on in Hong Kong for a period of not less than seven years after the completion of the transactions. The Commissioner may

consent to a shorter retention period in special circumstances (see ¶9-4500).

For more on the provision of information requirements, see ¶9-0100ff.

[¶1-3300] Duties of “representatives”

Incapacitated persons

When a taxpayer is incapacitated, the trustee of the taxpayer is responsible for fulfilling the requirements of the Ordinance on behalf of the taxpayer (see ¶9-3800).

Non-residents

The primary obligation to comply with the provisions of the Ordinances rests with the non-resident but an agent of a non-resident is also liable to ensure compliance by his or her non-resident principal (see ¶9-3800).

Executors

An executor of a deceased's estate is liable in his or her capacity as executor, but is not personally liable, to discharge any liability to tax which the deceased may have incurred prior to the date of death. Furthermore, an executor is obliged to ensure compliance with the Ordinance in exactly the same way as the deceased would be if he or she were alive (see ¶9-3900).

Partnerships

The “precedent partner” of any partnership is primarily responsible for ensuring that the provisions of the Ordinance are complied with (see ¶9-4000).

Corporations

The responsibility for observance of the various statutory requirements rests on all the officers of the corporation, including the secretary, manager, any director or, in appropriate circumstances, a liquidator. If none of these office bearers are ordinarily resident in Hong Kong, the corporation is obliged to inform the Commissioner of the name of a “resident” who is responsible for ensuring compliance with the Ordinance (see ¶9-4200).

Joint/Co-owners

Where there is more than one owner of land or building, all persons appearing on the records maintained at the Land Registry are responsible for discharging the liabilities and obligations imposed by the Ordinance (see ¶9-4100).

[¶1-3500] Objections and appeals

A taxpayer who is dissatisfied with an assessment, and who wishes to object to that assessment, must lodge a notice of objection (which

must be in writing) to the Commissioner within one month after the date of the notice of assessment. The Commissioner has power to extend this time period when he is satisfied that circumstances beyond the taxpayer's control (e.g. sickness or absence from Hong Kong) prevented an objection from being lodged within the prescribed period. The taxpayer's notice must clearly state, in as much detail as possible, the grounds upon which the objection is based.

In considering any objection, the Commissioner has power to call for further information and may compel any person who is able to give any useful evidence in respect of the assessment to attend for examination. The taxpayer lodging the objection has the right to appear personally or by a representative during the examination. After reviewing the objection, the Commissioner may increase, confirm, or annul the original assessment.

For more on objections and their determination, see ¶11-0100ff.

Board of Review

Appeal from a decision of the Commissioner lies with the Board of Review. A taxpayer wishing to appeal to the Board of Review must apply within one month of receiving the Commissioner's determination. The application is required to be in writing and contain a statement of the relevant facts. The grounds upon which the appeal is based must also be set out.

At any time before the hearing of an appeal by the Board of Review, the taxpayer and the Commissioner may reach a settlement as to the amount of income, profits or net assessable value of property on which the taxpayer is liable to be taxed. If the written settlement is endorsed by the Board, the appeal is not required to be heard.

See further ¶11-3250.

Court of First Instance

The decision of the Board of Review is final in all matters except for questions of law. If either the taxpayer or the Commissioner is dissatisfied with the Board's determination, an application may be made to the Court of First Instance for leave to appeal within one month of the Board's determination. There is also a right of appeal from a decision of the Commissioner direct to the Court of First Instance.

See further ¶11-5000.

Court of Appeal

The decision of the Court of First Instance can be appealed to the Court of Appeal. An appeal direct to the Court of Appeal from a decision of the Board of Review is available, providing that prior leave to appeal is granted by the Court of Appeal.

See further ¶11-6000.

Court of Final Appeal

Appeals to the Privy Council were abolished with effect from 1 July 1997.

Decisions of the Court of First Instance and the Court of Appeal may be appealed to the Court of Final Appeal in Hong Kong. There can be no further appeal from a decision of the Court of Final Appeal.

For more on appeals, see ¶11-3000ff.

[¶1-3700] Payment and recovery of tax

The notice of assessment issued to a taxpayer stipulates the amount of tax to be paid and also the time limit within which it must be paid. Any tax which is not paid in accordance with the terms of the assessment notice is deemed to be in default (see ¶10-1300) and is recoverable as a civil debt due to the Government (see ¶10-6700). Recovery proceedings may be instituted in the District Court notwithstanding that the amount involved exceeds the maximum amount which is ordinarily recoverable in the District Court.

The Commissioner does have a discretion to accept payment of outstanding taxes by instalments. This discretion will normally only be exercised where the taxpayer is able to prove hardship (see ¶10-1900).

Refunds

A claim for a refund of taxes which have been overpaid must be lodged within six years from the end of the relevant tax year or within six months from the date on which the notice of assessment was served (whichever is the later). If the claim is proved to the satisfaction of the Commissioner, the taxpayer is entitled to have the amount of the excess taxes refunded (see ¶10-8700).

Payment and recovery of tax are dealt with in Chapter 10 (¶10-0200ff).

[¶1-3900] Offences and penalties

Failure to comply “without reasonable excuse” (see ¶12-4400) with the various requirements of the Ordinance is an offence, for example:

- failure to furnish a return or furnishing an incorrect return;
- failure to comply with the Commissioner’s request for information;
- wilful intention to evade tax through false statements or supplying inaccurate information.

It is also an offence for breaches of official secrecy under the Ordinance.

Evasion

A person who wilfully intends to evade or assists another person in evading tax through, for example, non-disclosure, making false statements, providing false information or maintaining false records, is

guilty of an offence (see ¶12-5100). Penalties for wilful evasion range from a set fine, together with a further fine of treble the amount of tax undercharged, to imprisonment for three years. Severe penalties have been handed down by the courts in circumstances involving blatant tax evasion.

Offences and penalties are dealt with in Chapter 12 (¶12-0200ff).

STAMP DUTY ORDINANCE

¶1-4500 Overview of stamp duty scheme

Stamp duty is levied under the *Stamp Duty Ordinance* (Cap 117). Stamp duty applies only to instruments evidencing transactions which involve immovable property, stocks or shares. Some instruments attract a fixed amount of duty per instrument while others are subject to *ad valorem* duty.

Instruments which are chargeable with stamp duty are:

- instruments for the conveyance or lease of immovable property in Hong Kong (see ¶14-0400);
- agreements for the sale of immovable property in Hong Kong (see ¶14-1080);
- instruments for the sale, purchase or other transfer of Hong Kong stock (see ¶14-1550);
- Hong Kong bearer instruments (see ¶14-2700); and
- duplicates and counterparts (see ¶14-2900).

The Government has adopted several measures for the property market over the past years. To curb the overheated residential properties market, Special Stamp Duty (“SSD”) was introduced in November 2010, which is imposed on transactions of residential properties for all values if a residential property was acquired by the vendor or transferor on or after 20 November 2010 and resold or transferred not more than 24 months after its acquisition.

Effective from 27 October 2012, the *Stamp Duty Ordinance* was amended to impose higher rates of SSD on residential properties acquired on or after that date if a property is resold not more than 36 months after the acquisition. Furthermore, Buyer’s Stamp Duty (“BSD”) was also introduced to impose a duty of 15% on agreements for sale and conveyances on sale of residential properties executed on or after 27 October 2012 if the purchaser or transferor is not a Hong Kong permanent resident.

Pursuant to the *Stamp Duty (Amendment) (No. 2) Ordinance 2014*, a new scale of ad valorem stamp duty (“AVD”) rates has been introduced (Scale 1) and the charging of AVD on non-residential property

transactions has been advanced from the conveyance on sale to the agreement for sale effective from 23 February 2013. Any residential property (except limited circumstances such as acquisition by a Hong Kong permanent resident who does not own any other residential property in Hong Kong) and non-residential property acquired on or after 23 February 2013, either by an individual or a company, were then subject to the new rates of AVD (i.e. Scale 1, the so-called “double stamp duty”).

On 4 November 2016, the Government further introduced a new round of measures to increase the AVD to a new flat rate of 15% for residential properties acquired by individuals or companies (Scale 1 Part 1). The new measure was effective on 5 November 2016. Non-residential property transactions continued to be chargeable under the double stamp duty rates (Scale 1, Part 2).

However, in view of the recent falling prices and transaction volumes of non-residential properties, the *Stamp Duty (Amendment) Ordinance 2021* was passed on 2 June 2021 to revert the AVD rates applicable to non-residential property transactions from the double stamp duty back to the Scale 2 rates with retrospective effect from 26 November 2020.

Pursuant to the Budget Speech delivered by the Financial Secretary on 22 February 2023, adjustments were made to the value bands of the ad valorem stamp duty payable under Scale 2, with a view to easing the burden on ordinary families of purchasing their first residential properties, particularly small and medium residential units.

The current rates of ad valorem stamp duty (effective from 11:00am on 22 February 2023) are as follows:

Consideration	Scale 1	Scale 2
Not exceeding \$3,000,000		\$100
\$3,000,001 – \$4,500,000		1.5%
\$4,500,001 – \$6,000,000	15%	2.25%
\$6,000,001 – \$9,000,000		3%
\$9,000,001 – \$20,000,000		3.75%
Over \$20,000,000		4.25%

To increase the Government revenue and ease the fiscal deficit amidst the COVID-19 pandemic, the *Revenue (Stamp Duty) Bill 2021* was introduced to raise the rate of stamp duty on stock transfers from 0.1% to 0.13% with effect from 1 August 2021. The Bill was passed on 2 June 2021.

The amount of duty payable, the time limits within which the stamp duty must be paid (penalty rates apply if the instrument is not stamped in time), and the persons who have primary responsibility to pay the duty are all set out in the First Schedule to the Ordinance. The Collector of Stamp Revenue has the power to extend, in appropriate circumstances,

the time for payment of duty beyond the period referred to in the Schedule and to accept payment of any duty or penalty by instalments.

In addition to the person nominated in the Schedule as being responsible for payment of any stamp duty, any person who “uses” a document will incur a joint and several civil liability to the Collector for payment of the duty and penalties which may apply under the Ordinance. However, the Collector is not able to recover any stamp duty payable in respect of a document after the lapse of six years from the expiration of time for stamping of the document.

Stamp duty is dealt with in detail in Chapter 14 (¶14-0100ff).

¶1-4700 **Stamping procedure**

As a general rule, documents which are subject to duty must be submitted to the Stamp Office, with the appropriate amount of duty, for stamping (see ¶14-5030). The date of stamping and the amount of duty paid are impressed with a franking machine, thereby denoting that the document has been duly stamped in accordance with the Ordinance. The payment of duty may also be evidenced by the Stamp Office affixing an appropriate stamp bearing the words “Stamp Office Hong Kong”. If this alternative method is adopted, the date of stamping, the amount of the duty paid and the Collector’s signature must also appear. If the document is an instrument to which Pt IIA of the *Stamp Duty Ordinance* (Cap 117) applies, the Collector may issue a stamp certificate in respect of the document instead.

Contract notes for the sale or purchase of “Hong Kong stock” may be stamped by means of adhesive stamps in lieu of submitting the document to the Collector for stamping (see ¶14-5030).

There is no special form of construction required for instruments liable to stamp duty, except that stamp duty must be capable of appearing on the “face of the instrument” and when so affixed shall not be used for, or applied to, any other document (see ¶14-4950).

Electronic stamping was introduced in 2004 and is mainly applicable to property documents, such as sales and purchases agreement and tenancy agreement. However, e-stamping does not apply to cases which require adjudication or SSD or tenancy agreement which contains consideration other than rent. The electronic stamp certificates will be generated replacing conventional stamps. These certificates have the same legal status as conventional stamps on instruments. Authenticity check of certificates is available at the website of the Stamp Duty Office.

If an instrument contains or relates to several distinct matters, it is charged with duty in respect of each separate subject matter.

All the facts and circumstances affecting the amount and liability to stamp duty of a document are required to be fully set out in the instrument. In determining the liability of a document to stamp duty, the

Collector has the power to call for additional material in order to satisfy himself that all the facts and circumstances affecting the liability of the document to duty or the amount of duty chargeable on the instrument are fully disclosed therein (see ¶14-6000). Any person who, with intent to defraud the Government, (a) executes any document which does not contain all the relevant details, or (b) is involved in the preparation of any instrument and neglects to include all the facts and circumstances, commits a criminal offence (see ¶14-7700).

¶1-4900] Time limit for stamping

The period within which an instrument is required to be stamped is set out in the First Schedule (see ¶14-5190). Where a document is required to be stamped before “execution”, then it must be stamped prior to signature by any party to the instrument.

Late stamping

A document which is not stamped within the appropriate time period may be stamped by the Collector out of time upon payment of penalties, in addition to normal stamp duty, as follows:

- when the document is stamped within one month of the time limit imposed by the Ordinance, the penalty is double the duty listed in the Schedule;
- when stamped later than one month but within two months of the time limit, the penalty is four times the normal amount of stamp duty; and
- after the expiration of two months from the proper date, the penalty is 10 times the amount of the prescribed duty (see ¶14-5270).

The Collector has an overriding discretion to waive payment of part or all of these penalty rates of duty.

The penalty scheme outlined above does not apply where a request is made to the Collector for an opinion as to (i) whether an instrument is liable for duty and/or (ii) the amount of duty chargeable (see ¶14-6000). The duty only becomes payable after the expiration of one month from the date of the Collector’s adjudication, even though the time period in the Schedule may have expired.

¶1-5100] Duty on instruments

The Ordinance imposes duty on instruments rather than transactions. The amount or rate of duty and the types of instruments which are subject to stamp duty are listed in the First Schedule. The Schedule must be read in conjunction with the substantive provisions of the Ordinance, as the latter contains general as well as more specific requirements which modify and vary the liability to duty.

See further ¶14-3100ff.

[¶1-5200] Exemptions from stamp duty

The following exemptions are available:

- a general exemption for the Government;
- leases or conveyances of exempted premises between exempted persons;
- gifts to exempt institutions;
- conveyances between associated companies; and
- specific exemptions set out in various Ordinances (see ¶14-7000).

[¶1-5400] Offences

It is an offence to:

- falsify, mutilate or destroy any business records or other documents for the purpose of evading any stamp duty; or
- practice or be involved in any “fraudulent act, contrivance or device” with intent to defraud the Government of any stamp duty (see ¶14-7700).

Offences under the Ordinance are subject to a fine and imprisonment. Criminal proceedings for an offence must be instituted within two years of discovery of the offence or six years from the commission of the offence, whichever is the earlier. In the event of a corporation committing an offence with the consent of, or the connivance or neglect of, an officer of the company, then the officer is also guilty of an offence.

A magistrate may issue a search warrant to enable a search to be conducted of any premises if there is reason to believe that there are any records on the premises which tend to show that an offence under the Ordinance has been committed (see ¶14-8500).

ETHICS IN TAX PRACTICE

[¶1-6000] Code of Ethics

Every citizen has the legal and social responsibility to pay tax to the government on time. Hong Kong has a simple tax regime which can function effectively only if the taxpayer reports the income and deductions on a tax return that is true, correct and complete. Accountants have a duty to the tax system as well as to their clients. It is well-established that a taxpayer has no obligation to pay more tax than one legally owes, and a tax accountant has a duty to client to assist in achieving that result.

Guidance for accountants working in tax practice is codified in the Hong Kong Institute of Certified Public Accountants’ *Code of Ethics for Professional Accountants*, Section.600: Ethics in Tax Practice.

A practitioner rendering professional tax services is entitled to put forward the best position in favour of his client, provided that he can render the service with professional competence, it does not impair his standard of integrity and objectivity, and is in his opinion consistent with the law. He may resolve doubt in favour of his client if in his judgment there is reasonable support for his position (s 600.2).

One should not hold out to clients that the tax return he prepares and the tax advice he offers are beyond challenge. Instead, his clients should be informed of any limitations attaching to such tax advice and services so that an expression of opinion would not be misinterpreted as an assertion of fact (s 600.3).

When a tax practitioner undertakes or assists in preparing a tax return, he should make it clear to his client that the responsibility for the content of the return rests primarily with the client. He should take the necessary steps to ensure that the tax return is properly prepared based on the information received from the client (s 600.4).

In preparing a tax return for the client, reliance can be made on information furnished by the client provided that the information appears reasonable. Examination or review of documents or evidence in support of client's information is not required, but the client should be encouraged to provide such supporting data where appropriate. Reference should be made to the client's returns for prior years and reasonable enquiries are required where the information presented appears incorrect or incomplete (s 600.8).

Where it comes to notice a material error or omission in a client's tax return of a prior year, or of the failure of a client to file a required tax return, a tax practitioner should promptly advise his client of the error or omission and recommend the client making full disclosure to the Inland Revenue Department. If the client refuses to correct the error, he should inform the client that he cannot act for him in connection with that return or other related information submitted to the authorities, and to consider whether continued association with the client in any capacity is consistent with his professional responsibilities. If the answer is affirmative, he should take all reasonable steps to assure himself that the error is not repeated in subsequent tax returns. If he ceases to act for the client in these circumstances, he should advise the client of the position before informing the authorities of his having ceased to act. Under the revised Code of Ethics (effective 15 June 2019), he should also consider (as set out in paragraphs R360.38 – 360.40 A1 of the Code) whether disclosing the matter to the external auditor and/or the Inland Revenue Department is appropriate (s 600.9). This refers to the exceptional circumstances where a tax professional becomes aware of actual or intended conduct that he has reason to believe that it would constitute an imminent breach of a law or regulation that would cause substantial harm to investors, creditors, employees or the general public.

A tax practitioner must not associate himself with any return or communication that which he has reason to believe contains a false or misleading statement; contains statements or information furnished by the client recklessly without any real knowledge that they are true; or omits or obscures information required to be submitted which would mislead the Inland Revenue Department. If such situations prevail, he should resign from acting as the tax representative. Apart from informing the Inland Revenue Department of his withdrawal of his services, he may also consider whether disclosing the matter to the external auditor and/or the Inland Revenue Department is appropriate in the exceptional circumstances noted above (s 600.6).

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REVISION QUESTIONS

[¶1-9000] Test your knowledge

Question 1

Which of the following is NOT a correct administrative arrangement set out in the *Basic Law*?

- (a) The HKSAR shall practice an independent taxation system and enact its own tax law.
- (b) The HKSAR shall achieve fiscal balance, and to this end it may substantially increase the tax rates during the period of adverse economic condition.
- (c) The HKSAR shall keep the budget commensurate with the growth rate of its gross domestic product.
- (d) The HKSAR shall maintain a low tax regime.

Question 2

According to the *Code of Ethics for Professional Accountants*, in preparing a tax return for the client, which of the following statements are CORRECT?

- (I) A detailed examination and review of the documents in support of the client's information is required.
 - (II) Reliance can be made on information furnished by the client provided that the information appears reasonable.
 - (III) Reference should be made to clients' returns for prior years.
- (a) I and III only
 - (b) II and III only
 - (c) I, II and III
 - (d) None of the above

Question 3

You are newly appointed as the tax representative for Sparkle Ltd. Upon reviewing the tax return and supporting schedules submitted by the client to the Inland Revenue Department (IRD) last year, you noticed that the client has claimed a deduction of certain entertaining expenses which were in fact personal expenses of a major shareholder. The assessable profits for the year were accordingly understated. Under this circumstance, you should:

- (a) resign from the tax engagement immediately.
- (b) inform the Independent Commission Against Corruption about the findings.

- (c) inform the IRD directly in the capacity of the client's tax representative.
- (d) advise the client to inform the IRD and to request for additional assessment.

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[¶1-9100] Case study**Question 1**

Your CPA firm was recently engaged by Bright Colour Ltd as a tax representative and you are in charge of this new engagement. In reviewing the client's documents from last year, you noticed that there was a material error in the tax return submitted to the Inland Revenue Department.

Required:

What would be the proper course of actions to be taken by you as a tax practitioner with reference to the *Code of Ethics* issued by the Hong Kong Institute of Certified Public Accountants?

Question 2

Blue Sky Ltd carries on business in Hong Kong. The management recently decided to expand its business to the Mainland China and has appointed Jacob & Co., a local CPA firm, as its tax advisor to handle tax compliance issues and give tax advice in respect of its proposed operations in the Mainland.

Required:

Advise the ethical considerations of Jacob & Co. before it accepts the tax services engagement and in the course of providing tax services to the client.

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