



## **Frequently Asked Questions: Companies Incorporated Outside Hong Kong**

**Q.1 Is an offshore company, i.e. one incorporated outside Hong Kong, liable to pay Hong Kong profits tax?**

A.1 The Inland Revenue Ordinance (“IRO”) contains no exemption from profits tax for offshore companies. Whether an offshore company is liable to profits tax depends on the nature and extent of its activities in Hong Kong.

**Q.2 Under what circumstances is an offshore company liable to profits tax?**

A.2 Generally speaking, a company is liable to profits tax if it carries on a trade, profession or business in Hong Kong and has profits arising in or derived from Hong Kong from such trade, profession or business. This applies equally to Hong Kong companies and those incorporated overseas.

**Q.3 How does the IRD decide whether a company is carrying on a business in Hong Kong?**

A.3 This is a question of fact and has to be decided by reference to the circumstances of each case. It should, however, be noted that a company needs not have extensive activities in Hong Kong before it is considered to be carrying on a business here. Furthermore, the activities of a company’s agents in Hong Kong may also be relevant.

**Q.4 How does the IRD decide whether a company’s profits arise in or are derived from Hong Kong?**

A.4 Again this is a question of fact. The general guideline is to ascertain the operations of the company that give rise to the profits and the places where such operations are carried out. Further details of the IRD’s views on the determination of the territorial source of profits are contained in Departmental Interpretation and Practice Note (“DIPN”) No. 21: Locality of Profits, which can be downloaded from the IRD’s website at [http://www.ird.gov.hk/eng/pdf/e\\_dipn21.pdf](http://www.ird.gov.hk/eng/pdf/e_dipn21.pdf).

**Q.5 What are the reporting requirements for an offshore company carrying on a business in Hong Kong?**

A.5 An offshore company carrying on a business in Hong Kong is subject to the same reporting requirements as a Hong Kong company. The basic requirements are that the company has to register its business with the Business Registration Office of the IRD and to furnish profits tax returns issued to it.

If the company has profits chargeable to tax for any year of assessment but has not received any return from the IRD, it has to inform the IRD in writing of its liability within 4 months after the end of the basis period for that year of assessment.

Furthermore, the company is required to keep sufficient records (in English or Chinese) to enable its assessable profits to be readily ascertained and the records must be retained for at least seven years after the completion of the relevant transactions.

**Q.6 Is it necessary for an offshore company to submit audited accounts when it files its profits tax return?**

A.6 Where the company is incorporated in a jurisdiction whose laws do not require accounts to be audited and no audit has been performed on the company's accounts, the IRD would accept unaudited accounts filed in support of the return. However, if an audit has actually been carried out notwithstanding that there was no such requirement under the laws of the relevant jurisdiction, the audited accounts should be submitted with the return.

Where an offshore company's head office is outside Hong Kong but it has a branch in Hong Kong, the IRD is generally prepared to accept unaudited branch accounts without the cover of audited world-wide accounts. However, the assessor may request a copy of the audited world-wide accounts if circumstances warrant.

**Q.7 My company has made some royalty payments to an offshore company which as far as I know does not carry on any business in Hong Kong. Is the royalty income of the offshore company chargeable to profits tax?**

A.7 Even if the offshore company does not carry on any business in Hong Kong, the royalties it received are nevertheless chargeable to profits tax if they are:

- (a) payments received from the exhibition or use in Hong Kong of cinematograph or television film or tape, any sound recording, or any advertising materials connected with such film, tape, or recording; or
- (b) payments received for the use of or right to use in Hong Kong any patent, design, trademark, copyright material or secret process or formula or other property of a similar nature, or for imparting or undertaking to impart knowledge connected with the use in Hong Kong of any such patent, design, etc; or
- (c) payments received for the use of or right to use outside Hong Kong any patent, design, trademark, copyright material or secret process or formula or other property of a similar nature, or for imparting or undertaking to impart knowledge connected with the use outside Hong Kong of any such patent, design, etc, which are deductible in ascertaining the assessable profits of a person under Profits Tax (not applicable to sums received or accrued before 25 June 2004).

In the above situation, the assessable profits are taken to be 30% of the payments (or 10%, if the payments were received by or accrued to the offshore company before 1 April 2003) but may be taken to be 100% of the payments if the offshore company is your company's associate. The tax payable is then computed by applying the appropriate tax rate to the assessable profits so arrived at. Furthermore, the offshore company is chargeable in your company's name and your company is required under the IRO to withhold from the payments made to the offshore company sufficient money for the payment of the tax.

**Q.8 Are there any tax rules that are specifically relevant to offshore companies?**

A.8 Basically, offshore companies and Hong Kong companies are treated in the same way. However, if a company is a non-resident, the following should be noted:

- (a) A non-resident is chargeable to tax either directly or in the name of his agent in respect of his Hong Kong sourced profits from a trade, profession or business carried on in Hong Kong. The tax may be recovered out of the assets of the non-resident or from the agent and the agent is required to retain from the non-resident's assets sufficient money to pay the tax.
- (b) A non-resident receiving royalty income as described in the answer to question 7 is subject to profits tax in the way explained therein.

- (c) A local person (including a company) who sells goods in Hong Kong on behalf of a non-resident shall furnish quarterly returns to the IRD showing the gross proceeds from the sales and at the same time pay to the IRD a sum equal to 1% of the sales proceeds, or such lesser sum as may have been agreed by the IRD.
- (d) Where a non-resident carries on business with a closely-connected resident person and the business is so arranged that it produces to the resident person either no profits or less than the ordinary profits, the business may be deemed to be carried on in Hong Kong by the non-resident through the resident person as his agent.
- (e) Where a non-resident receives sums directly or indirectly from the performance in Hong Kong by a non-resident entertainer or sportsman, special procedures of assessment and collection of tax would apply. For more details, see pamphlet: “Taxation of non-resident entertainers and sportsmen in Hong Kong”, which can be downloaded from the IRD’s website at <http://www.ird.gov.hk/eng/pdf/pam48e.pdf>.

It should however be noted that whether a company is a non-resident is largely a question of fact and that not every offshore company is regarded as a non-resident.

**Q9. How can an offshore company be more certain about whether its activities will give rise to profits tax liability?**

A9. The company may consider applying, on payment of an appropriate fee, for an advance ruling under section 88A of the IRO in respect of a contemplated transaction or arrangement. Details of the application procedures are set out in DIPN No. 31: Advance Rulings, which can be downloaded from the IRD’s website at [http://www.ird.gov.hk/eng/pdf/e\\_dipn31.pdf](http://www.ird.gov.hk/eng/pdf/e_dipn31.pdf).

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