Inland Revenue Department
The Government of the Hong Kong Special Administrative Region
of the People's Republic of China

DEPARTMENTAL INTERPRETATION AND PRACTICE NOTES

NO. 17 (REVISED)

THE TAXATION OF PERSONS CHARGEABLE TO PROFITS TAX ON BEHALF OF NON-RESIDENTS

These notes are issued for the information and guidance of taxpayers and their authorised representatives. They have no binding force and do not affect a person's right of objection and appeal to the Commissioner, the Board of Review or the Courts.

These notes replace those issued on 15 March 1989.

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Commissioner of Inland Revenue

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INTRODUCTION

These practice notes lay down broad statements on the practice to be adopted by the Department in relation to the taxation responsibilities of persons in Hong Kong who may be chargeable to Profits Tax on behalf of non-residents.

THE POSITION IN GENERAL

2. A non-resident who carries on a trade, profession or business in Hong Kong is chargeable to Profits Tax under section 14 in respect of profits arising in or derived from Hong Kong from such trade, profession or business. Thus, for example, a non-resident entertainer or sportsman who performs in Hong Kong is chargeable to Profits Tax in respect of the payment he derives from his performance here. In addition, a non-resident person who does not carry on business in Hong Kong and who may have no physical presence here is still liable to Profits Tax if, for example, he receives sums in the form of royalties or licence fees for the use of or right to use in Hong Kong certain industrial or intellectual property. Such receipts are deemed by section 15(1) to arise in or be derived from Hong Kong from a trade, profession or business carried on in Hong Kong. These receipts comprise sums received or accrued from the exhibition or use in Hong Kong of cinema or television film or tape, any sound recording, or any advertising material connected with such items [section 15(1)(a)] and sums received or accrued for the use of or right to use in Hong Kong any patent, design, trademark, copyright material, secret process or formula or similar property, or for imparting or undertaking to impart knowledge connected with such items [section 15(1)(b)]. Following the enactment of the Inland Revenue (Amendment) Ordinance 2004, the scope of taxable receipts is extended to cover sums received or accrued for the use of or right to use outside Hong Kong the intellectual properties enumerated in section 15(1)(b), which are deductible in ascertaining assessable profits of a person for the purpose of Profits Tax [section 15(1)(ba)]. This new section does not apply to sums received or accrued before 25 June 2004.

THE ASSESSMENT AND COLLECTION PROVISIONS – SECTION 20A

3. For many years the Department has relied on section 20A to enable the tax due by a non-resident to be assessed and collected even where the non-resident has no physical presence in Hong Kong. The terms of section 20A provide that a non-resident person may be assessed directly or in the name of his agent in respect of his profits arising in or derived from Hong Kong from any trade, profession or business carried on in Hong Kong. The section further provides that the tax so charged shall be recoverable from the assets of the non-resident or his agent. The term "agent" in relation to a non-resident is defined in section 2 to include :-

(a) the agent, attorney, factor, receiver or manager in Hong Kong of such person, and

(b) any person in Hong Kong through whom such person is in receipt of any profits or income arising in or derived from Hong Kong.

Until a High Court decision in 1987 (referred to in paragraph 4 below) the Department took the view that any person in Hong Kong who paid to a non-resident sums in respect of which the non-resident was assessable to tax in Hong Kong was an agent in terms of the above definition. Consequently, that person in Hong Kong could be charged to Profits Tax under section 20A as agent of the non-resident. In the light of that court decision the Department's view is no longer tenable.

INTERPRETATION OF "AGENT"

4. The meaning of "agent" was brought before the High Court in *CIR v. Asia Television Limited [1987] 2 HKTC 198*. The case concerned the payment of licence fees by Asia Television Limited (ATV) to a non-resident film distribution company under a licence agreement to broadcast in Hong Kong films supplied by the non-resident. The licence fees were paid directly by ATV to the non-resident outside Hong Kong. Such fees are chargeable to Profits Tax under section 15(1)(a). Assessments were raised on ATV as agent for non-resident. On appeal the High Court held that in the circumstances of the

case the non-resident was in receipt of income not through but rather from ATV. Consequently ATV was not an "agent" as defined and could not be charged under section 20A in respect of the licence fees paid to the non-resident. It followed, of course, that the non-resident could only be charged by direct assessment.

5. As a result of the ATV decision, the Department is unable to use section 20A to assess non-residents where the Hong Kong person and the non-resident deal with each other on a principal to principal basis, as was the situation in the ATV case. Because it is not uncommon for non-residents in receipt of royalties and licence fees from Hong Kong and for non-resident entertainers and sportsmen who perform in Hong Kong to derive income not through a Hong Kong agent but from a Hong Kong principal, it has been necessary to amend the law to restore the position, as far as possible, to that which was thought to have existed prior to the ATV decision.

THE ASSESSMENT AND COLLECTION PROVISIONS – SECTION 20B

6. Against this background the Inland Revenue (Amendment) Ordinance 1989 introduced a new section 20B which applied from 1 April 1989. It should be noted, however, that section 20A has remained unchanged and continues to apply in situations where the Hong Kong payer is truly an agent of the non-resident. Section 20B only applies to situations where persons in Hong Kong who are not agents deal with a specified class of non-residents. In essence this class comprises non-residents in receipt of royalties and licence fees from Hong Kong and non-resident entertainers and sportsmen who perform in Hong Kong.

7. Following the enactment of the Inland Revenue (Amendment) Ordinance 2004, the coverage of section 20B is expanded. The section now applies in respect of a non-resident who is chargeable to Profits Tax in respect of :-

(a) sums deemed under section 15(1)(a), (b) or (ba) to be receipts derived from Hong Kong from a trade, profession or business carried on in Hong Kong, in other words, royalties and licence fees;or

(b) sums received in respect of the performance in Hong Kong by a non-resident entertainer or sportsman of an activity as an entertainer or sportsman on or in connection with a commercial occasion or event, including appearance in any promotional activity or participation in any sound recording, films, videos, radio, television etc.

8. The Ordinance contains no definition of "non-resident person" but the Department, as a matter of administrative practice, has long accepted in relation to section 20A that the term refers to a person who has no permanent business presence in Hong Kong. No difficulties or disputes have arisen on this point in the past and it is therefore not likely that the term will cause problems in relation to section 20B. In case there are disputes, the term will be interpreted in accordance with the principles established by the courts.

DEFINITION OF CERTAIN TERMS

9. The phrases "entertainer or sportsman" and "commercial occasion or event" are defined in section 20B(4). The definitions are largely self-explanatory and require little comment :-

"Entertainer or sportsman" means a person, other than a corporation, who gives performances in any kind of entertainment or sport, including any physical activity which the public is permitted to see or hear. In terms of the definition it matters not whether the activity is in a live or recorded form or whether the public is required to make payment to see or hear.

"Commercial occasion or event" includes any occasion or event for which an entertainer might receive cash or other form of property for his performance, or any occasion or event designed to promote commercial sales or activity. As presently defined, it is considered that the phrase will cover all those occasions or events, whether commercial or charitable, in respect of which an entertainer or sportsman might receive profits assessable to tax.

ASSESSMENT IN NAME OF HONG KONG PERSON – SECTION 20B

10. Where section 20B applies, a non-resident person is chargeable to tax in the name of the Hong Kong person who paid or credited sums (see paragraph 7) to him or any other non-resident. In addition, section 20B(2) provides that the tax so charged is recoverable by all means provided in the Ordinance from the Hong Kong person. Thus, where a Hong Kong person pays to a non-resident royalties or licence fees in the circumstances prescribed by section 15(1)(a), (b) or (ba), he will be chargeable to tax on behalf of the non-resident in respect of the payment. Similarly, a Hong Kong promoter or sponsor will be chargeable in respect of any payment made by him to a non-resident entertainer or sportsman for performing in Hong Kong.

11. It should be noted that in terms of section 20B(2) the Hong Kong person would remain chargeable to tax on behalf of the non-resident even if the payment or credit was made to a non-resident other than the non-resident who is chargeable by virtue of section 20B(1), for example, where the payment is made to the manager of a non-resident entertainer who is himself a non-resident. Section 20B would also be applicable where sums falling within subsection (1) were paid by a Hong Kong person to another Hong Kong person for the account of a non-resident. In this situation the other Hong Kong person would be chargeable on behalf of the non-resident.

DEDUCTION OF TAX BY HONG KONG PERSON

12. Section 20B(3), like section 20A(2), requires the Hong Kong person from whom tax is recoverable, in other words, the person who is chargeable on behalf of the non-resident, to deduct at the time he pays or credits the non-resident a sum sufficient to meet the tax due. At this particular time no assessment may have been raised and in such case the Hong Kong payer should retain the sum deducted until a demand note calling for payment is received from the Department. Section 20B(3) also contains an indemnity to the Hong Kong person in respect of the sum deducted to meet the tax liability.

THE AMOUNT OF TAX TO BE WITHHELD

13. In determining the amount of tax to be withheld by the Hong Kong person, in the case of royalties and licence fees falling within section 15(1)(a), (b) or (ba), the provisions of section 21A should be followed. The operation of section 21A is explained in the Departmental Interpretation and Practice Notes No. 22.

14. With regard to non-resident entertainers and sportsmen, the Department has for many years advised Hong Kong promoters to withhold tax on the basis that assessable profits represent two-thirds of the gross receipts payable to the entertainer or sportsman. In other words, a deduction for expense equal to one-third of the gross proceeds is automatically allowed by the Department in computing the assessable profits of a non-resident entertainer or sportsman. This arrangement is, from a strictly legal point of view, properly authorised by section 21 which enables the assessable profits of a non-resident to be computed on a percentage of turnover. The Department will continue to apply this arrangement in the future. Non-residents are, of course, at liberty to make claims for deduction which are greater than the automatic allowance to which I have referred above. However, in such cases the Department will require that full particulars of the expenses be produced and that such expenses be properly deductible in terms of the Ordinance.

REPAYMENT OF TAX INVOLVING NON-RESIDENTS

15. Finally, it should be noted that the Inland Revenue (Amendment) Ordinance 1989 also amends section 79(3) to provide that where a non-resident person has been assessed in the name of another person under section 20A or 20B and the tax so assessed has been paid by the other person, either the other person or the non-resident, but not both, may claim repayment of any tax overpaid. In this regard, the Department takes the view that the term “another person” in section 79(3), as amended, covers both an “agent” referred to in section 20A and “any person in Hong Kong” in section 20B.