

# Hong Kong Profits Tax: A Territorial Approach

Understanding the basis of taxation

Hong Kong operates a **territorial** tax system. This means that only profits sourced within Hong Kong are subject to Profits Tax. This blog post will explain this concept in simple terms, focusing on Profits Tax implications for businesses operating in Hong Kong.

## What is the Territorial Basis of Taxation?

The territorial basis of taxation means that Hong Kong only taxes profits that arise in or are derived from Hong Kong. If your business operates in Hong Kong but generates profits from activities outside of Hong Kong, those offshore profits are generally not subject to Hong Kong Profits Tax. In essence, the *source* of the profit determines its taxability.

This is a crucial aspect of Hong Kong's tax regime, making it an attractive location for businesses with international operations. However, determining the *source* of profits can sometimes be complex.

## Profits Tax: The Basics

Profits Tax is levied on profits derived from a trade, profession, or business carried on in Hong Kong. The key is that the *business* must be carried on *in* Hong Kong, and the *profits* must be *sourced* in Hong Kong.

Here are the current Profits Tax rates:

- **Two-tiered profits tax rates regime:**
  - For corporations, the profits tax rate is 8.25% on the first HKD 2 million of assessable profits, and 16.5% on any profits exceeding that amount.
  - For unincorporated businesses (partnerships, sole proprietorships), the profits tax rate is 7.5% on the first HKD 2 million of assessable profits, and 15% on any profits exceeding that amount.

## Profits Sourced In and Outside of Hong Kong: Examples

### Profits Sourced In Hong Kong:

- Sales of goods where contracts are concluded in Hong Kong.
- Provision of services performed in Hong Kong.
- Rental income from properties located in Hong Kong.

### Profits Sourced Outside Hong Kong:

- Sales of goods where contracts are concluded outside Hong Kong.
- Provision of services performed entirely outside Hong Kong.
- Royalties derived from intellectual property used outside Hong Kong.

These are simplified examples, and the actual determination of the source of profits can be complex and fact-specific.

## Important Considerations

- **Source vs. Remittance:** Hong Kong taxes profits based on their *source*, not whether they are remitted to Hong Kong. Even if profits earned outside Hong Kong are brought into Hong Kong, they are not taxable if their source is outside Hong Kong.
- **Substance over Form:** The Inland Revenue Department (IRD) looks at the substance of transactions, not just their legal form, to determine the source of profits.
- **Seeking Professional Advice:** Determining the source of profits can be complex. It's recommended to seek professional tax advice to ensure compliance with Hong Kong tax laws.

## Summary

Hong Kong's territorial tax system offers significant advantages for businesses operating internationally. By understanding the principles of source-based taxation, businesses can effectively manage their tax obligations in Hong Kong. Remember to always seek professional advice for specific tax planning and compliance matters.