



Basic Tests for Liability to Profits Tax

In order for a person to be chargeable to profits tax, three conditions must be satisfied –

1. The person must carry on a trade, profession or business in Hong Kong;
2. The profits to be charged must be from such trade, profession or business carried on by the person in Hong Kong; and
3. The profits must be profits arising in or derived from Hong Kong.

In the light of the various court decisions, the Inland Revenue Department's views on the locality of profits derived from trading in commodities or goods by a business carried on in Hong Kong can be summarized as follows –

1. Where both the contract of purchase and contract of sale are effected in Hong Kong, the profits are fully taxable.
2. Where both the contract of purchase and contract of sale are effected outside Hong Kong, no part of the profits are taxable.
3. Where either the contract of purchase or contract of sale is effected in Hong Kong, the initial presumption will be that the profits are fully taxable.
4. Where the sale is made to a Hong Kong customer, the sale contract will usually be taken as having been effected in Hong Kong.
5. Where the commodities or goods are purchased from either a Hong Kong supplier or manufacturer, the purchase contract will usually be taken as having been effected in Hong Kong.
6. Where the effecting of the purchase and sale contracts does not require travel outside Hong Kong but is carried out in Hong Kong by telephone, fax etc., the contracts will be considered as having been effected in Hong Kong.
7. But, “effected” cannot merely mean legally executed (as this would depend on formal legal rules of offer and acceptance) and must contemplate the actual steps leading to the existence of the contracts including the negotiation and, in substance, conclusion and execution of the contracts.
8. Moreover, the purchase and sale contracts are important factors but the totality of facts must be looked at to determine the locality of the profits.



Reinvoicing

There may be cases where the activities of a Hong Kong trading business are limited to the following –

1. Issuing or accepting an invoice (not order) to or from an ex-Hong Kong customer or supplier (whether related or not) on the basis of contracts of sale or purchase already effected by an ex-Hong Kong associate;
2. Arranging letters of credit;
3. Operating a bank account, making and receiving payments; and
4. Maintaining accounting records.

This situation commonly arises when a Hong Kong business, as a member of a group and pursuant to group directives, carries out the above activities and "books" the profits in Hong Kong. Provided the activities of the Hong Kong business do not include the acceptance or issuance of sale or purchase orders in or from Hong Kong, the profits would not be taxable.

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