



**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. 23 (REVISED)**

**RECOGNIZED RETIREMENT SCHEMES**

These notes are issued for the information of taxpayers and their tax representatives. They contain the Department's interpretation and practices in relation to the laws as it stood at the date of publication. Taxpayers are reminded that their right of objection against the assessment and their right of appeal to the Commissioner, the Board of Review or the Court are not affected by the application of these notes.

These notes replace those issued in September 2006.

WONG Kuen-fai  
Commissioner of Inland Revenue

May 2019

# DEPARTMENTAL INTERPRETATION AND PRACTICE NOTES

## No. 23 (REVISED)

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## INTRODUCTION

### *Regulatory frameworks on retirement schemes*

In recognition of the need to provide retirement benefits to employees, tax relief in relation to the setting up of and benefits withdrawn from retirement schemes was made available to employers and employees as early as 1955. The tax concessions and administration provisions in the Inland Revenue Ordinance (IRO) evolved with the development of more sophisticated regulatory frameworks on retirement schemes in Hong Kong. Major changes were made in 1993 following the introduction of the Occupational Retirement Schemes Ordinance (Cap. 426) (ORSO) and in 1998 to pave the way for the implementation of the mandatory provident fund (MPF) system.

2. The Mandatory Provident Fund Schemes Ordinance (Cap. 485) (MPFSO), enacted in 1995, provides for the operations and regulations of the MPF system in Hong Kong. The MPFSO has been continually amended to refine the administration, operation and enforcement of the MPF system since its full operation in December 2000. Schedule 3B to the IRO has been amended to increase the maximum amount of deduction allowable under sections 16AA and 26G to align with the increase of the maximum level of relevant income for MPF mandatory contributions. The Mandatory Provident Fund Schemes (Amendment) Ordinance 2015, enacted in January 2015, amended the IRO, inter alia, to extend the tax exemption to cover withdrawal of accrued benefits by instalments and on the ground of terminal illness. The Inland Revenue and MPF Schemes Legislation (Tax Deductions for Annuity Premiums and MPF Voluntary Contributions) (Amendment) Ordinance 2019, enacted in March 2019, provides tax incentives for MPF scheme members to make tax deductible MPF voluntary contributions (TVC) starting from 1 April 2019.

3. This Departmental Interpretation and Practice Note (DIPN) explains the principal features in the IRO in so far as they affect employers and employees in regard to contributions to and withdrawals from retirement schemes. It was revised in September 2006, incorporating the legislative amendments on MPF contributions and other changes in practice. Having reviewed the tax treatment for defined benefit schemes, and taking into account the recent legislative amendments, it is considered appropriate to revise this DIPN to bring it up-to-date.

## **DIFFERENT RETIREMENT SCHEMES**

### ***Approved retirement schemes***

4. Before the commencement of the ORSO in October 1993, there was no statutory body in Hong Kong to regulate the operations of retirement schemes established for the benefits of employees. At that time, the Commissioner approved retirement schemes that satisfied the conditions set out in the Inland Revenue (Retirement Scheme) Rules as approved retirement (AR) schemes under section 87A (repealed). Tax relief was granted to AR schemes.

### ***Recognized occupational retirement schemes***

5. After the ORSO came into operation in October 1993, the Registrar of Occupational Retirement Schemes assumed responsibility for the registration and regulation of retirement schemes. Following the repeal of section 87A of the IRO and the Inland Revenue (Retirement Scheme) Rules by the Inland Revenue (Amendment) (No. 5) Ordinance 1993 in November 1993, the Commissioner ceased to approve retirement schemes.

6. The Inland Revenue (Amendment) (No. 5) Ordinance 1993 also brought about a number of other changes to the IRO that had an impact on both salaries tax and profits tax, reinstating those requirements contained in the repealed Inland Revenue (Retirement Scheme) Rules. In the main, it preserved the practical position that had long prevailed under those Rules.

### ***Mandatory provident fund schemes***

7. In the MPF system, a mandatory provident fund (MPF) scheme means a provident fund scheme as defined under section 2(1) of the MPFSO and registered under that ordinance. Except for the exempt persons stipulated in the MPFSO, the MPF system covers employees and self-employed persons aged between 18 and 65. Under the MPFSO, employers are required to enrol employees in an MPF scheme. Every MPF scheme has to be registered with the Mandatory Provident Fund Schemes Authority (MPFA). Persons exempt from MPF schemes include:

- (a) domestic employees;
- (b) self-employed hawkers;
- (c) people covered by statutory pension or provident fund schemes, such as civil servants and subsidized or grant school teachers;
- (d) members of occupational retirement schemes which are granted MPF exemption certificates;
- (e) people from overseas who enter Hong Kong for employment for not more than 13 months, or who are covered by overseas retirement schemes; and
- (f) employees of the European Union Office of the European Commission in Hong Kong.

Details relating to the operations of the MPF system can be found on the website of the MPFA at [www.mpfa.org.hk](http://www.mpfa.org.hk).

### ***Recognized retirement schemes***

8. Before going into detail about the tax treatments of contributions to and benefits received from retirement schemes under different regimes, it is necessary to refer to the meaning of various schemes as they appear in the IRO and their significance.

9. The term “recognized occupational retirement scheme” (ROR scheme) is defined to include those AR schemes where the approval has not been withdrawn, schemes registered under the ORSO or exempted from registration under the ORSO, schemes established by a foreign government or its non-profit making agencies, schemes established under other ordinances, etc. The term “mandatory provident fund scheme” means a provident fund scheme registered under the MPFSO.

10. The collective term “recognized retirement scheme” covers an ROR scheme or an MPF scheme, the two types of retirement schemes that may enjoy tax benefits.

11. The change from one regime to the next very often involved the winding up of schemes registered under a previous regime and the establishing of a scheme under the following regime. When ORSO came into operation, schemes previously approved by the Commissioner under section 87A (repealed) could be registered upon application as an ROR scheme. The Commissioner's approval under section 87A (repealed) was deemed to have been withdrawn when a scheme became an ROR scheme or if the scheme was not so registered by 15 October 1993. Similarly, on or before the commencement of the MPF contribution provisions on 1 December 2000, there were options available to employers operating an ROR scheme in changing to schemes under the MPF system. The options included the following:

- (a) the ORSO scheme was converted to an MPF-exempted ORSO scheme (upon application and subject to approval by the MPFA) and either the employer did not establish an MPF scheme or the employer established an MPF scheme to operate concurrently with the MPF-exempted ORSO scheme;
- (b) the ORSO scheme was retained to provide top-up benefits and the employer established an MPF scheme in which all employees were enrolled;
- (c) the ORSO scheme was wound-up and the employer established an MPF scheme.

Different options can have different taxation implications and they are elaborated in paragraphs below.

## **IMPORTANT DEFINITIONS AND CONCEPTS**

### ***Distinction between “retirement” and “termination of service”***

12. For the purposes of the exemption provisions of section 8(2)(c) and (cc) of the IRO, the terms, “retirement” and “termination of service”, are defined in section 8(3). “Retirement” means:

- (a) a retirement from the service of the employer at some specified age of not less than 45 years; or
- (b) a retirement after some specified period of service with the employer of not less than 10 years; or
- (c) the attainment of the age of 60 or some specified age of retirement, whichever is the later.

“Termination of service” means a termination of employment other than upon retirement, death, incapacity or terminal illness. Withdrawals from recognized retirement schemes on retirement and those on termination of service have different tax implications.

### ***Contributions to MPF schemes***

13. Employers, employees and self-employed persons are required to make contributions to the MPF schemes they have joined out of or by reference to the income of the employees or the self-employed persons. In general, contributions can be classified into mandatory contributions and voluntary contributions. Mandatory contributions and voluntary contributions attract different tax treatments.

#### ***Mandatory contributions***

14. For the purposes of the IRO, mandatory contribution means the mandatory contribution paid to an MPF scheme in accordance with the MPFSO. It is calculated on the basis of 10% on an employee’s relevant income, with the employer and the employee each paying 5%. Contributions are generally made on a monthly basis. The employer’s mandatory contributions shall be payable from the first day of employment. There is a 30-day non-contributory period for an employee who takes up a new employment. The employee is also not required to make employee’s mandatory contributions for any incomplete payroll period immediately following the 30-day non-contributory period (if the employee’s payroll period is monthly or shorter than monthly) or the calendar month in which the 30<sup>th</sup> day of employment falls (if the employee’s payroll period is longer than monthly). The initial

non-contributory period does not apply to employers. Self-employed persons<sup>1</sup> have to contribute 5% of their relevant income. They can opt to make contributions on a monthly or yearly basis.

15. Employees earning less than the minimum level of the relevant income are not required to contribute, but their employers have to contribute 5% of their relevant income. The mandatory contribution is capped at 5% of the maximum relevant income. These maximum and minimum levels of income also apply to self-employed persons. The past and current minimum and maximum relevant income levels are set out below:

<b>Effective date</b>	<b>Minimum relevant income level</b>	<b>Maximum relevant income level</b>	<b>Mandatory contribution capped @ 5%</b>
1 December 2000	\$4,000	\$20,000	\$1,000
1 February 2003	\$5,000	\$20,000	\$1,000
1 November 2011	\$6,500	\$20,000	\$1,000
1 June 2012	\$6,500	\$25,000	\$1,250
1 November 2013	\$7,100	\$25,000	\$1,250
1 June 2014	\$7,100	\$30,000	\$1,500

16. Before 1 November 2008, housing allowance and other housing benefit were excluded from the definition of “relevant income”, under section 2(1) of the MPFSO, for the purposes of calculating the mandatory contributions. Thereafter, the term “relevant income” means any wages, salaries, leave pay, fee, commission, bonus, gratuity, perquisite or allowance (including housing allowance or other housing benefit), expressed in monetary terms, paid or payable by an employer (directly or indirectly) to that employee in consideration of his employment under that contract, but excludes severance and long service payments under the Employment Ordinance (Cap. 57). The relevant income of a self-employed person is basically his assessable profits calculated in accordance with the IRO, as shown in his most recent notice of assessment.

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<sup>1</sup> In general, sole proprietors and partners in a partnership business are regarded as self-employed persons.

### *Voluntary contributions*

17. In addition to mandatory contributions, employers, employees and self-employed persons can make contributions or increase their contributions to an MPF scheme on a voluntary basis in accordance with section 11 of the MPFSO. MPF voluntary contributions, other than TVC, made by employees and self-employed persons are not deductible for tax purposes.

### *Tax deductible MPF voluntary contributions*

18. With effect from 1 April 2019, deduction in respect of TVC paid into a TVC account during a year of assessment is allowable under section 26S(1) to a person chargeable to salaries tax or tax under personal assessment. A TVC account receives TVC made by a TVC account holder, and also holds the account holder's accrued benefits derived from those TVC and the TVC transferred to the account from other TVC accounts.

19. A person may open a TVC account in a registered MPF scheme if the person holds a contribution account or personal account in the registered scheme; or is a member of an ORSO scheme in respect of which an exemption has been granted under section 5 of the MPFSO. A contribution account primarily receives MPF contributions attributable to a person's current employment or current self-employment for investment. A personal account primarily receives accrued benefits attributable to a person's former employment or former self-employment transferred from other MPF accounts, and also accrued benefits attributable to the person's current employment transferred from a contribution account for investment.

20. TVC means tax deductible MPF voluntary contributions that a person pays into a TVC account which holds the person's accrued benefits derived from those contributions and the person's accrued benefits transferred to the account.

21. The total deductions allowable to the person in respect of qualifying annuity premiums and TVC cannot exceed the amount specified in Schedule 3F as per Section 26U(1). See DIPN No. 57 on "Concessionary Deductions: Section 26N to 26U Annuity Premiums and MPF Voluntary Contributions" for further details. For the year of assessment 2019/20 and subsequent years, the maximum deduction is specified at \$60,000 and it is an aggregate limit for qualifying annuity premiums and TVC.

22. Like MPF mandatory contributions, TVC is subject to the preservation requirements, meaning that withdrawal is allowed only upon retirement at the age of 65 or on statutorily permissible grounds (including early retirement at the age of 60, permanent departure from Hong Kong, total incapacity, terminal illness, small balance and death).

## **ASSESSABILITY OF SUMS RECEIVED BY EMPLOYEES**

### ***Amounts attracting salaries tax liability***

23. Persons with income arising in or derived from Hong Kong from an office or employment are chargeable to salaries tax. Definition of the term “income from office or employment” is provided in section 9(1). Other than pensions, which are specifically chargeable under section 8(1)(b), assessability of amounts received by an employee from retirement schemes, whether by way of commutation or otherwise, is as follows:

- (a) amounts received from a pension or provident fund, scheme or society which is not an ROR scheme or an MPF scheme, as is attributable to the employer’s contributions, are chargeable per section 9(1)(aa);
- (b) where the amount from an ROR scheme is received not because of termination of service, death, incapacity, terminal illness or retirement of the employee, the full amount of the employer’s contributions under the scheme in respect of the employee concerned is chargeable per section 9(1)(ab)(i);
- (c) where the amount is received from an ROR scheme because of termination of service, the amount of the employer’s contributions that exceeds the proportionate benefit as calculated in accordance with section 8(5) is chargeable per section 9(1)(ab)(ii);
- (d) any payment received by an employee, pursuant to a judgment given under section 57(3)(b) of the ORSO that is attributable to his employer’s contributions to the occupational retirement scheme in respect of which the

judgment was given is chargeable per section 9(1)(ac). Section 57(3) of the ORSO allows the Court to determine the amount of any shortfall in the funding of a beneficiary's vested benefits under a scheme and to make an order against the employer for that shortfall;

- (e) so much of the accrued benefit that an employee has received, or is taken to have received, from an MPF scheme otherwise than on the ground of retirement, death, incapacity, terminal illness or termination of service whether in a lump sum or by instalments, as is attributable to his employer's contributions to the scheme, is chargeable per section 9(1)(ad);
- (f) so much of the accrued benefit that an employee has received, or is taken to have received, from an MPF scheme, as is attributable to his employer's voluntary contributions to the scheme which exceeds the proportionate benefit calculated in accordance with section 8(5), is chargeable per section 9(1)(ae).

After the employee's total income for a year of assessment has been ascertained in accordance with the above, the charging provisions, section 8(1), (1A) and/or (1B) will be applied according to the employee's situations.

24. It should be noted that in the case of ROR schemes, liability arises when the amount is received, unless it is received under circumstances where exemptions are applicable. Regarding accrued benefits from MPF schemes, liability can arise when the benefit is taken to have been received. In general, only benefits attributable to the employer's contributions to an ROR scheme or voluntary contributions to an MPF scheme (including investment return arising therefrom) attract salaries tax liability. Accrued benefits or sums (including investment return), attributable to the employee's contributions, withdrawn from the trust funds are not chargeable to salaries tax. Such withdrawals may be viewed as withdrawals of the employee's savings.

***Summary of the position***

25. To give symmetry to the assessment provisions, section 8(2) contains provisions on exemption of sums or accrued benefits received from recognized retirement schemes. Summary of the position is:

Circumstances under which accrued benefits are received	ROR scheme		MPF scheme	
	Sum attributable to:		Accrued benefit attributable to:	
	Employee's contributions	Employer's contributions	Employee's mandatory and voluntary contributions	Employer's mandatory and voluntary contributions
Retirement	Exempt	Exempt	Exempt	Exempt
Death	Exempt	Exempt	Exempt	Exempt
Incapacity	Exempt	Exempt	Exempt	Exempt
Terminal illness	Exempt	Exempt	Exempt	Exempt
Termination of service	Exempt	Exempt but subject to proportionate benefit rule –s.8(2)(c)(i) –s.8(2)(cc)(i) –s.9(1)(ab)(ii)	Exempt	<u>Mandatory:</u> Exempt <sup>2</sup> <u>Voluntary:</u> Exempt but subject to proportionate benefit rule –s.8(2)(cc)(ii) –s.9(1)(ae)
Permanent departure from Hong Kong but without terminating service	Exempt	Assessable in full –s.9(1)(ab)(i)	Exempt	<u>Mandatory:</u> Exempt –s.8(2)(cb) <u>Voluntary:</u> Assessable in full –s.9(1)(ad)
Any circumstances other than those listed above	Exempt	Assessable in full –s.9(1)(ab)(i)	Exempt	Assessable in full –s.9(1)(ad)

<sup>2</sup> The accrued benefit received under the circumstance is not regarded as income in section 9(1)(ad).

26. In the case of an ROR scheme that has lost its “recognized” status, only relevant sums paid prior to the loss of that status can be considered for exemption under section 8(2)(c) or (cc). All payments received subsequent to the revocation of recognition will be considered for assessment under section 9(1)(aa).

27. The Chief Executive in the 2018 Policy Address announced the abolition of the arrangement for offsetting severance payment or long service payment with accrued benefits from the employer’s mandatory contributions under the MPF system, and the preparatory work is actively being undertaken. Until the abolition becomes effective, if the employer has not paid the whole of the severance payment or long service payment to an employee as required by the Employment Ordinance, the employee may, by virtue of section 12A(3) and (4) of the MPFSO, require the approved trustee of the MPF scheme to pay him the shortfall out of the accrued benefit attributable to the employer’s contribution. Example 5 below illustrates the situation which involves setting off of severance payment or long service payment against the taxable accrued benefits received. Sums received by the employee attributable to voluntary contributions of the employer are exempt under section 8(2)(cc)(ii), subject to the proportionate benefit rule and the restriction under section 8(7) and (8). Example 12 below illustrates the application of these sections and their relationship with section 8(4) and (5). Sums received attributable to the employer’s mandatory contributions are not taxable.

***Proportionate benefit***

28. Special conditions apply to limit the amount of the employer’s voluntary contribution component of any payment received upon termination of service that may be exempted from salaries tax under section 8(2)(c) or (cc). The maximum amount that is exempt from salaries tax is the lesser of the relevant amount received or the proportionate benefit. Mathematically, the proportionate benefit is calculated using the formula set out in section 8(5):

$$\text{Proportionate benefit} = \text{Accrued benefit} \times \frac{\text{Completed months of service}}{120}$$

### *Accrued benefit*

29. For the purposes of computing the proportionate benefit in section 8(5), accrued benefit is defined in section 8(6) to mean:

- (a) if a person is a member of an ROR scheme, accrued benefit refers to the maximum benefit that the person would have been entitled to receive from the scheme as if the person had retired when his employment was terminated; and
- (b) if a person is a member of an MPF scheme, accrued benefit refers to that benefit which is attributable to the employer's voluntary contribution in respect of the person for his service.

30. Where an ROR scheme contains more than one method for calculating the retirement benefit that would have been payable on that date, the option which provides the greatest benefit to the employee is to be used. In the case of a defined contribution scheme, the accrued benefit will be the sum attributable to the aggregate contributions made by or in respect of that person and investment return arising therefrom. In the case of a defined benefit scheme, the accrued benefit must be calculated in accordance with the method recommended by the actuaries of the scheme. Actuaries are not required to obtain the Commissioner's approval for the calculation method recommended for any scheme. However, if a particular recommended method has resulted in an accrued benefit which appears to be somewhat excessive, after taking into account the period of employment and the salary received during that period, the Commissioner may obtain independent actuarial advice. In this regard, taxpayers will, of course, have the usual right of objection and appeal in respect of the chargeable income calculation.

31. Under an MPF scheme, mandatory contributions paid for and in respect of an employee are fully and immediately vested in the employee once they are paid to the MPF trustee. Investment return attributable to mandatory contributions is also fully and immediately vested in the employee. Conversely, the employer's voluntary contributions under an MPF scheme are made on a voluntary basis and are not subject to the preservation, vesting and portability requirements as stipulated in the MPFSO. Any investment return derived from investment of the employer's voluntary contributions under an MPF scheme is subject to a vesting scale under the governing rules drawn up

by the employer. The employer's voluntary contributions held by a trustee of an MPF scheme are subject to forfeiture if the conditions are not fulfilled, or in the event that the employee resigns, or is dismissed due to misconduct, etc. At the time when the employer's voluntary contributions are paid to the trustee of an MPF scheme, the employee only receives a promise with respect to such contributions. The employee is only entitled to claim payment when the employer's voluntary contributions (including investment return derived therefrom) are vested in the employee free of all conditions.

32. The nature of the employer's voluntary contributions under an MPF scheme is no different from the employer's contributions under an ROR scheme<sup>3</sup>. Thus, for the purposes of computing the proportionate benefit, the amount of the employee's accrued benefit attributable to the employer's voluntary contributions paid to the MPF scheme should be accorded with that attributable to the employer's contributions paid to the ROR scheme. The words "attributable to" in this context refer to the investment of the employer's contributions, which include employer's contributions, whether mandatory or voluntary, and investment return arising therefrom. In other words, the accrued benefit is equal to the vested balance of the investment of the employer's voluntary contributions under the MPF scheme or contributions under an ROR scheme. The investment return derived from the employer's voluntary contributions under an MPF scheme or contributions under an ROR scheme is not to be excluded.

#### *Completed months of service*

33. This term refers to the number of completed months of service that the employee has completed with the employer. It is referable to the whole period of employment that the employee had with the employer. This term should not be confused with the number of days or months that the employee has rendered services in Hong Kong for the purposes of section 8(1A) and/or (1B).

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<sup>3</sup> Excluding employees who join MPF-exempted ORSO schemes after 1 December 2000. The Mandatory Provident Fund Schemes (Exemption) Regulation stipulates that accrued benefits in respect of an employee who joined an ORSO scheme after the launch of the MPF System on 1 December 2000 are subject to the preservation, portability and withdrawal requirements up to an amount equivalent to the minimum MPF benefits.

34. Where there has been a transfer of benefit from a scheme operated by a previous employer to the current employer's scheme, the service with the previous employer that has been recognized by the present scheme as qualifying service with the current employer can be taken into account in calculating the completed months of service.

*Illustrative examples*

35. The following examples illustrate the application of the proportionate benefit calculation. In all cases, the "accrued benefit" and the "payment received" are the respective amounts attributable to the employer's voluntary contributions only.

Example 1

- (a) *Period of service: 5 years*
- (b) *Accrued benefit on termination of service: \$100,000*
- (c) *Payment received from the scheme: \$50,000*

Calculation of proportionate benefit per section 8(5):

$$\begin{aligned}\text{Proportionate benefit} &= \$100,000 \times \frac{60}{120} \text{ months} \\ &= \underline{\$50,000}\end{aligned}$$

Calculation of taxable benefit per section 8(4):

$$\begin{aligned}\text{Taxable benefit} &= \text{Payment received} - \text{proportionate benefit} \\ &= \$50,000 - \$50,000 \\ &= \underline{\text{Nil}}\end{aligned}$$

Example 2

- (a) *Period of service: 5 years*
- (b) *Accrued benefit on termination of service: \$100,000*
- (c) *Payment received from the scheme: \$60,000*

Calculation of proportionate benefit per section 8(5):

$$\begin{aligned}\text{Proportionate benefit} &= \$100,000 \times \frac{60}{120} \text{ months} \\ &= \underline{\$50,000}\end{aligned}$$

Calculation of taxable benefit per section 8(4):

$$\begin{aligned}\text{Taxable benefit} &= \$60,000 - \$50,000 \\ &= \underline{\$10,000}\end{aligned}$$

### Example 3

- (a) *Period of service: 5 years*
- (b) *Accrued benefit on termination of service: \$100,000*
- (c) *Payment received from scheme per vesting scale approved previously by the Commissioner: \$60,000*

Calculation of proportionate benefit per section 8(4):

$$\text{Proportionate benefit} = \underline{\$60,000}$$

Calculation of taxable benefit per section 8(4)(a):

$$\begin{aligned}\text{Taxable benefit} &= \$60,000 - \$60,000 \\ &= \underline{\text{Nil}}\end{aligned}$$

### Example 4

- (a) *Employee had a transfer of benefits from a scheme operated by a previous employer.*
- (b) *Period of employment with previous employer: 2 years*
- (c) *Period of employment with current employer as at the date of termination of service: 5 years*
- (d) *Period of service recognized by the scheme: 7 years*
- (e) *Accrued benefit on termination of service: \$100,000*
- (f) *Payment received from the scheme: \$70,000*

Calculation of proportionate benefit per section 8(5):

$$\begin{aligned}\text{Proportionate benefit} &= \$100,000 \times \frac{84}{120} \text{ months} \\ &= \underline{\$70,000}\end{aligned}$$

Calculation of taxable benefit per section 8(4):

$$\begin{aligned}\text{Taxable benefit} &= \$70,000 - \$70,000 \\ &= \underline{\text{Nil}}\end{aligned}$$

### Example 5

- (a) *Period of service: 5 years*
- (b) *Made redundant by Employer at the end of the period of service, at which time salary was \$22,500 per month.*
- (c) *Employer would pay severance payment according to Employment Ordinance after setting off the accrued benefits attributed to the Employer's contributions, both mandatory and voluntary, under the MPF scheme.*
- (d) *Severance payment was calculated as:  $\$22,500 \times 2/3 \times 5 = \$75,000$*
- (e) *Accrued benefit attributable to the Employer's mandatory contributions \$40,000 and voluntary contributions \$30,000 under the scheme was paid to Employee upon request.*
- (f) *Severance payment received from Employer after setting off the accrued benefit in (e) above:  $\$75,000 - (\$40,000 + \$30,000) = \$5,000$*

Calculation of proportionate benefit per section 8(5):

$$\begin{aligned}\text{Proportionate benefit} &= \$30,000 \times \frac{60}{120} \text{ months} \\ &= \underline{\$15,000}\end{aligned}$$

Calculation of taxable benefit per section 8(4):

$$\begin{aligned}\text{Taxable benefit} &= \$30,000 - \$15,000 \\ &= \underline{\$15,000}\end{aligned}$$

The amount subject to salaries tax was \$15,000 while severance payment of \$5,000 received from Employer would not be taxable.

### Example 6

- (a) *Employee was seconded to Hong Kong for 1 year after having been employed by Employer for 10 years outside Hong Kong.*
- (b) *Period of employment as at the date of termination of service: 11 years*
- (c) *Employee joined an overseas Retirement Plan prior to and during his Hong Kong secondment.*
- (d) *The Retirement Plan qualified as an ROR scheme and Employee was exempt from joining a MPF scheme in Hong Kong.*
- (e) *Accrued benefit on termination of service: \$100,000*
- (f) *Payment received from Retirement Plan: \$100,000*

Calculation of proportionate benefit per section 8(5):

$$\begin{aligned}\text{Proportionate benefit} &= \$100,000 \times \frac{132}{120} \text{ months} \\ &= \underline{\underline{\$110,000}}\end{aligned}$$

Calculation of taxable benefit per section 8(4):

$$\begin{aligned}\text{Taxable benefit} &= \$100,000 - \$110,000 \\ &= \underline{\underline{\text{Nil}}}\end{aligned}$$

Employee was under the same employment for 11 years. The number of completed months of services of Employee with Employer was 132. No taxable benefit would arise since the accrued benefit attributable to the Employer's voluntary contributions \$100,000 was less than the proportionate benefit \$110,000.

### Example 7

- (a) *Employee had an employment with Employer-1 outside Hong Kong for 10 years when he was covered by an overseas Retirement Plan. Period of service with Employer-1: 10 years*
- (b) *Employee ceased his employment with Employer-1 and employed under a new employment by Employer-2, which was a group company in Hong Kong. Employee was covered by an MPF scheme and his period of service with Employer-2: 1 year*
- (c) *Period of service recognized by Employer-2: 11 years*
- (d) *Voluntary contributions made by Employer-2 to the MPF scheme: \$90,000 (subject to the vesting scale)*
- (e) *Accrued benefits on termination of service: \$100,000*
- (f) *Payment received from an MPF scheme: \$100,000*

Calculation of proportionate benefit per section 8(5):

$$\begin{aligned}\text{Proportionate benefit} &= \$100,000 \times \frac{12}{120} \text{ months} \\ &= \underline{\$10,000}\end{aligned}$$

Calculation of taxable benefit per section 8(4):

$$\begin{aligned}\text{Taxable benefit} &= \$100,000 - \$10,000 \\ &= \underline{\$90,000}\end{aligned}$$

Employer-1 and Employer-2, which were within the same group, were separate legal entities. Benefits were not transferred from the Retirement Plan to the MPF scheme. Though Employer-1 and Employer-2 were group companies, the completed months of service in the formula for calculating proportionate benefit should not cover the employment period with Employer-1 (i.e. 10 years or 120 months).

## ***Withdrawal of MPF benefits***

### *Early withdrawal of accrued benefit*

36. Accrued benefit arising from mandatory contributions made by the employer and employee has to be preserved until the employee attains the retirement age of 65 as stipulated in the MPFSO. Early withdrawal of the accrued benefit is however allowed in the circumstances applicable to the employee as follows:

- (a) early retirement and attainment of age 60;
- (b) permanent departure from Hong Kong;
- (c) total incapacity;
- (d) terminal illness;
- (e) having a small balance account of less than \$5,000 and providing that the employee has not made contributions to a scheme for 12 months and has declared to retire; and
- (f) death.

### *Permanent departure from Hong Kong without termination of service*

37. Section 158(2) of the Mandatory Provident Fund Schemes (General) Regulation (Cap. 485 sub. leg. A) provides that a scheme member departs from Hong Kong permanently if the member departs from Hong Kong to reside elsewhere with no intention of returning for employment or to resettle in Hong Kong as a permanent resident. Section 9(1)(ad) of the IRO provides that income from any employment includes the accrued benefit that an employee has received, or is taken to have received, from an MPF scheme (otherwise than on the ground of retirement, death, incapacity, terminal illness or termination of service, whether in a lump sum or (if applicable) as an instalment), as is attributable to contributions paid to the scheme by his employer. However, under section 8(2)(cb), specific exemption has been accorded to accrued benefit received from the approved trustee of an MPF scheme, whether in a lump sum or (if applicable) as an instalment, on the

ground of a person's retirement from employment, death, incapacity, terminal illness or permanent departure from Hong Kong, as is attributable to mandatory contributions. The net effect of these two provisions is that for cases where there is permanent departure from Hong Kong but without termination of service, the accrued benefit received which is attributable to the employer's mandatory contributions is not taxable, but that attributable to the employer's voluntary contributions is taxed in full. On the other hand, if the accrued benefit is to remain with the scheme and only paid out to the employee when one of the exemption conditions is satisfied (e.g. retirement), there should be no tax liability.

### *Incapacity*

38. The term "incapacity", as defined in section 8(3) of the IRO, means permanent unfitness to perform the kind of work that a person was last performing before becoming incapacitated. A person who applies for early withdrawal of accrued benefit on the ground of incapacity should have already ceased employment or self-employment in the particular kind of work that the person was last engaged before becoming totally incapacitated. Before making such an application, the person must obtain proof that he has become permanently unfit to perform the particular kind of work he was doing in his previous job. In addition, his previous employment has been terminated. Accrued benefit withdrawn on the ground of incapacity is exempt from salaries tax.

### *Terminal illness*

39. With effect from 1 August 2015, "terminal illness" became an additional ground for early withdrawal of accrued benefit. The definition of "terminal illness" in section 8(3) adopts the same meaning of section 158(3) of the Mandatory Fund Schemes (General) Regulation (Cap. 485 sub. leg. A). Terminal illness refers to an illness that is likely to reduce the life expectancy of the person to 12 months or less. The person who applies for early withdrawal of accrued benefit on the ground of terminal illness must obtain a medical certificate from a registered medical practitioner or a registered Chinese medicine practitioner. There is no specific list of diseases that are considered to constitute terminal illness. The terminally-ill person can still be employed or self-employed. Similar to other special circumstances for early withdrawal, accrued benefit so withdrawn is exempt from salaries tax.

### *Withdrawal of accrued benefit by instalments*

40. Starting from 1 February 2016, MPF accrued benefits are allowed to be withdrawn by instalments upon retirement or early retirement. Applications should be submitted directly to the relevant trustees. There is no limit on the amount of each instalment or the number of withdrawals. Trustees must not charge any fee, impose any penalty or make any deduction from the scheme members' accounts, other than necessary transaction costs (e.g. costs in selling and buying investments) for the payment of accrued benefits by instalments in any year for the first four instalments of that year. As for early withdrawal of accrued benefits on the ground of permanent departure from Hong Kong, total incapacity, terminal illness or having small balance, withdrawal of MPF accrued benefits by instalments is not allowed. Under such special circumstances, accrued benefits are allowed to be withdrawn in a lump sum. For members of ROR schemes, the equivalent of their mandatory contributions (i.e. minimum MPF benefits) will normally be transferred to an MPF scheme upon termination of employment, and the additional option of withdrawal by instalments will be available to them upon such a transfer. Withdrawal of accrued benefits by instalments will not be subject to salaries tax.

### *Accrued benefit received or taken to have been received from MPF schemes*

41. Under the MPF system, it is permissible for an employee who has terminated his service with an employer to retain his accrued benefit in the same MPF scheme to which his former employer has made contribution, or to transfer the accrued benefit to another MPF scheme, for example, one sponsored by his new employer. In both situations, the employee is taken to have received the accrued benefit pursuant to section 8(9).

42. Section 8(2)(cb) exempts accrued benefit received from an MPF scheme, whether in a lump sum or (if applicable) as an instalment, on the ground of a person's retirement from employment, death, incapacity, terminal illness or permanent departure from Hong Kong as is attributable to mandatory contribution. The situation described in the foregoing paragraph (i.e. an employee terminating his service) does not fall within the exemption provisions of section 8(2)(cb). On the other hand, section 9(1)(ad) excludes as income the accrued benefit from an MPF scheme received or taken to have been received on the ground of retirement, death, incapacity, terminal illness or

termination of service, whether in a lump sum or (if applicable) as an instalment, as is attributable to the employer's contributions (both mandatory and voluntary). When the above provisions are taken together, the accrued benefit attributable to the employer's mandatory contributions in situation of termination of service and transfer of the benefit to another MPF scheme should be exempt. Accrued benefit attributable to the employer's voluntary contributions in the same situation should also be exempt but subject to the proportionate benefit rule. By virtue of section 9(1)(ae), so much of the accrued benefit that an employee has received or is taken to have received from an MPF scheme as is attributable to the employer's voluntary contributions that exceeds the proportionate benefit will be included as the employee's income.

43. There are situations involving transfer of benefit from one MPF scheme to another but without termination of service or any of the exemption conditions being satisfied. For example, the employer sets up a new MPF scheme and transfers all employees from the old MPF scheme to the new scheme, or there is a transfer of benefit upon an employee's permanent departure from Hong Kong without termination of service. In these kinds of situations, the employees should be taken to have received the accrued benefit attributable to the employer's contributions. By virtue of section 9(1)(ad), the accrued benefit is chargeable to tax in the year of transfer. The exemption provisions in section 8(2)(cb) and (cc)(ii), which refer to receipts, whether in a lump sum or (if applicable) as an instalment, on the ground of retirement, death, incapacity, terminal illness or termination of service, would have no application. The expression "taken to have received" in section 9(1)(ad) is interpreted no differently from that used in section 8(9). However, the Commissioner recognizes that, in the circumstances described above, the employee concerned has not actually received, and cannot choose to receive, the accrued benefit and the benefit may be subject to tax again when it is finally received by the employee. As a concession, the Commissioner would not seek to assess the transferred benefit in the year of transfer if the transfer is not or part of a tax avoidance arrangement. The chargeability will be determined when it is received by the employee or when there is a termination of service.

44. Following the implementation of the Employee Choice Arrangement on 1 November 2012, an employee may opt, once a year, to transfer the accrued benefit derived from his mandatory contributions in an MPF scheme under current employment to another MPF scheme of his own choice. There is no tax implication on the employee upon transfer of the

accrued benefit attributable to his mandatory contributions under the Employee Choice Arrangement.

### ***Changing from ROR schemes to MPF schemes***

#### *Application of section 8(4)*

45. When a person “switched” from a AR scheme to a scheme established subsequently, a question may arise as to whether the vesting scale of the AR scheme can be carried across to the new scheme if it is more advantageous to employees than the proportionate benefit rule itself. The latter part of section 8(4) provides that where, in the case of an ROR scheme approved by the Commissioner under section 87A before its repeal by the Inland Revenue (Amendment) (No. 5) Ordinance 1993, if an amount payable on termination of service in accordance with the rules of such scheme exceeds the proportionate benefit so calculated, the amount payable is to be taken as the proportionate benefit.

46. The above provision takes into consideration that there is a substitution of one scheme by another. This may occur where the trustees of a scheme switch the funding from one investment vehicle to another in a way which entails termination of the scheme and its replacement by a new scheme. In this regard, if the substance of the new scheme is essentially the same as the original scheme (i.e. identical membership; transfer of all investments and funds to the new scheme; no change to vesting scale; and terms and conditions relating to membership and members’ rights substantially unaltered) it will generally be treated on the basis that it represents a continuation of the original scheme.

47. For illustration, the latter part of section 8(4) is applied in the following situations:

- (a) an AR scheme, which operated as an ROR scheme, was converted into an MPF-exempted scheme; and
- (b) the employer established an MPF scheme to replace the ROR scheme which was previously an AR scheme and employees were required to join the MPF scheme and the ROR scheme would be wound up; before the commencement of the MPF

contribution provisions on 1 December 2000, employees transferred all their benefits from the ROR scheme to the new MPF scheme.

48. In the above situations, the new scheme is recognized as a continuation of an earlier scheme, the Commissioner's approval of the earlier scheme under section 87A (repealed) will be preserved (i.e. it will be taken to apply to the new scheme). Nevertheless, changes of this nature should be notified to the Commissioner within one month of implementation.

49. The treatment applicable to the situation mentioned in paragraph 47(b) is by concession only. If a person was transferred from an ROR scheme to a new MPF scheme on or after the commencement of the MPF contribution provisions, the person's membership in the first scheme is considered to have ceased in all respects upon payment of the transfer value from the first scheme to the new scheme. It follows that if a termination payment is subsequently received from the new scheme, it will be regarded as having arisen from that scheme. In this situation, the proportionate benefit rule, rather than the provision in the latter part of section 8(4), will apply to the payment.

#### *Salaries tax implications to employees*

50. Examples 8 to 11 below illustrate the salaries tax liabilities of employees in different situations.

##### Example 8

*Employer converted an existing ROR scheme to an MPF-exempted ORSO scheme. The MPF-exempted ORSO scheme could remain open or closed to new members.*

There was no tax implication for Employees upon conversion of the schemes. The scheme remains an ROR scheme. Any sum withdrawn upon termination of service was exempt subject to the proportionate benefit rule. Withdrawal upon retirement, death, incapacity or terminal illness was exempt.

### Example 9

*Employer retained an existing ROR scheme, and at the same time an MPF scheme was set up. Existing scheme members could join the MPF scheme, with the option to:*

- (a) withdraw the accrued benefit attributable to the Employer's contribution under the ROR scheme;*
- (b) remain in the ROR scheme to provide top-up benefit to be received in future; or*
- (c) transfer the accrued benefit attributable to the Employer's contribution from the ROR scheme to the MPF scheme.*

The tax implication in respect of each option is as follows:

#### Option (a)

The amount received was fully taxable. None of the conditions for exemption (i.e. termination of service, retirement, death, incapacity and terminal illness) was satisfied.

#### Option (b)

There was no tax implication in the interim as no payment was received. If withdrawal of the accrued benefit from the ROR scheme was made only when one or more of the conditions for exemption were satisfied, the amount received was exempt, subject to the proportionate benefit rule in the case of termination of service.

#### Option (c)

There was no tax implication in the interim as no payment was received. The accrued benefit would be treated as if it remained in the ROR scheme. Alternatively, the accrued benefit transferred to the MPF scheme was deemed to be a voluntary contribution from Employer to the MPF scheme. If withdrawal of the accrued benefit was made only when one or more of the conditions for exemption were satisfied, the amount received was exempt, subject to the proportionate benefit rule in the case of termination of service. The provision in the latter part of section 8(4) would only apply as a concession if the ROR scheme in question qualified for its

application and the transfer of the accrued benefit took place before 1 December 2000.

#### Example 10

*The existing ROR scheme was wound up when Employer set up an MPF scheme which all employees were required to join.*

The same considerations for options (a) and (c) in Example 9 would be relevant.

#### Example 11

*Employer retained an existing MPF scheme, and at the same time an ROR scheme was set up. Existing MPF scheme members were given the option to:*

- (a) remain in the MPF scheme; or*
- (b) become members of the ROR scheme.*

*Employees choosing option (b) to enrol in the ROR scheme would have their current employment contracts with Employer terminated and immediately entered into new employment contracts with Employer with the same position, same duties and at the same salary. They would retain their accrued benefits in the MPF scheme and authorize Employer to maintain all their accrued benefits in the MPF contribution accounts.*

#### Option (a)

There would be no tax implication as Employees remained members of the MPF scheme.

#### Option (b)

Since Employees would continue to work for Employer in the same position with the same duties and same salary, there was no termination of service with Employer for the purposes of salaries tax. The full amount of accrued benefits taken to have received by Employees as attributable to contributions, whether mandatory or voluntary, paid to the MPF scheme by Employer would be treated as assessable income under section 9(1)(ad).

***Restrictions where employer is not chargeable to profits tax***

51. Where the accrued benefit withdrawn by an employee is attributable to the voluntary contributions paid by an employer who is not chargeable to profits tax, the amount of the accrued benefit attributable to the employer's contribution to be excluded from the income of the employee shall not exceed an amount equal to 15% of the total remuneration of the employee in the period of 12 months preceding the date on which the accrued benefit is received multiplied by the employee's completed years of service with the employer, as reduced by so much of the accrued benefit received by the employee as is attributable to the mandatory contribution of the employer. In practice, this restriction under section 8(8) is generally applicable to cases where the employer is a charitable body or other non-commercial organization such as a university. Example 12 below illustrates how the proportionate benefit rule and the restrictions under section 8(7) and (8) work together.

Example 12

*Employer who was a charitable institution operated an MPF scheme. On top of the mandatory contributions, Employer made voluntary contributions to the scheme at 16% of the employees' relevant income. Employee who earned an annual income of \$100,000 withdrew from the scheme all his accrued benefits attributable to the Employer's contributions in the following circumstances:*

(a) *On retirement, death, incapacity or terminal illness with 10 years of service*

Accrued benefit attributable to Employer's mandatory contribution payable to Employee as advised by the scheme trustee (\$50,000 is exempt under section 8(2)(cb).)	\$50,000
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Accrued benefit attributable to Employer's voluntary contribution payable to Employee as advised by the scheme trustee	\$160,000
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Amount exempted: 15% limit under section 8(7) and (8)  
 $(\$100,000 \times 15\% \times 10) - \$50,000$  \$100,000

Taxable benefit  
 $\$160,000 - \$100,000$  (i.e. excess over 15% limit) \$60,000

*(b) On termination of service with 6 years of service*

Accrued benefit attributable to Employer's mandatory contribution due to Employee as advised by the scheme trustee (cannot be received by Employee unless Employee departed from Hong Kong permanently at the same time) \$30,000

Accrued benefit attributable to Employer's voluntary contribution due to Employee as advised by the scheme trustee \$96,000

Exemption amount: 15% limit under section 8(7) and (8)  
 $(\$100,000 \times 15\% \times 6) - \$30,000$  \$60,000

Exemption amount under proportionate benefit rule  
 $\$96,000 \times 72/120$  \$57,600

Taxable benefit taken to have been received  
 $\$96,000 - \$57,600^{(*)}$  \$38,400

<sup>(\*)</sup> The deductible sum is the lesser of the two exemption amounts.

(c) *On termination of service with 8 years of service*

Accrued benefit attributable to Employer's mandatory contribution due to Employee as advised by the scheme trustee (cannot be received by Employee unless Employee departed from Hong Kong permanently at the same time)	\$40,000
Accrued benefit attributable to Employer's voluntary contribution due to Employee as advised by the scheme trustee	\$128,000
Exemption amount: 15% limit under section 8(7) and (8) $(\$100,000 \times 15\% \times 8) - \$40,000$	\$80,000
Exemption amount under proportionate benefit rule $\$128,000 \times 96/120$	\$102,400
Taxable benefit taken to have been received $\$128,000 - \$80,000^{(**)}$	<u>\$48,000</u>

<sup>(\*\*)</sup>The deductible sum is the lesser of the two exemption amounts.

52. It should be pointed out that the Department may, in exceptional cases, apply the restriction to cases where the employer, though carrying on business, is not chargeable to profits tax (for example, because its profits are wholly derived outside Hong Kong) if it is found that advantage is being taken of the tax status of the employer to reduce the employee's salaries tax liabilities.

## **DEDUCTION ALLOWED TO EMPLOYEES UNDER SALARIES TAX AND PERSONAL ASSESSMENT**

### ***Maximum amount of deduction***

53. Section 26G of the IRO applies in relation to the year of assessment commencing on 1 April 2000 and to all subsequent years of assessment. Under section 26G, contribution made by an employee to a recognized retirement scheme is an allowable deduction under salaries tax and personal assessment. Recognized retirement schemes include both ROR schemes and MPF schemes. The amount of deduction is, however, limited to that specified in Schedule 3B to the IRO which is equivalent to the maximum amount of mandatory contributions payable in accordance with the MPFSO. The maximum amount specified in Schedule 3B is as follows:

<u>Year(s) of assessment</u>	<u>Maximum amount of deduction</u>
2000/01 to 2011/12	\$12,000
2012/13	\$14,500
2013/14	\$15,000
2014/15	\$17,500
2015/16 and thereafter	\$18,000

54. A person taking up more than one employment may be required to make contributions to more than one scheme. He can claim deduction of mandatory contributions paid on all schemes, with the aggregate deductions claimed not exceeding the maximum amount. Any sum allowable as a deduction under Part 4 (Profits Tax) of the IRO cannot be deducted again under section 26G. In other words, contributions made by self-employed persons and claimed as allowable deduction for profits tax purposes cannot be claimed as a deduction under section 26G.

55. In the case of contributions made by a person to an ROR scheme, the amount allowed for deduction is the lesser of the actual amount contributed or the amount of mandatory contribution that the person would have been required to pay as an employee had that scheme been an MPF scheme. The total deduction allowable to a person for a year of assessment under section 26G cannot exceed the amount specified in Schedule 3B.

## **DEDUCTION ALLOWED TO EMPLOYERS UNDER PROFITS TAX**

### ***Contributions made by employers***

56. A special contribution, as distinct from an ordinary annual contribution in the case of an ROR scheme or a regular contribution in an MPF scheme, or a premium, other than an ordinary annual premium in respect of a contract of insurance under an ROR scheme, will be allowed as a deduction but to the extent that it is made in respect of individuals employed for the purposes of producing profits chargeable to profits tax and that it is not excessive in view of all the relevant circumstances. The deduction will be allowed under section 16A(2) at an even rate over the basis period of each of the five years of assessment commencing from that year during whose basis period the special contribution was actually made.

57. For this purpose, contributions made to an MPF scheme at regular intervals of similar or substantially similar amounts or of amounts calculated by reference to a scale or a fixed percentage of a person's salary or other remuneration are treated under section 16A(3) as regular contributions.

58. Ordinary annual contributions to or ordinary annual premiums for a contract of insurance under an ROR scheme or regular contributions (mandatory or voluntary or both) to an MPF scheme by an employer for the benefit of his employees are in general outgoings or expenses allowable for deduction under section 16(1) to the extent that they are incurred in the production of profits in respect of which the employer is chargeable to profits tax. The deduction is, however, limited under section 17(1)(h) to 15% of the total emoluments of the employee for the period to which the payments relate. For this purpose, the term "total emoluments" refers to total taxable emoluments of an employee from the employment or office and includes all allowances and benefits in kind, such as housing benefits. Provision made for the payment of contribution or premium referred to in section 17(1)(h) in excess of the 15% limit will also not be deductible under section 17(1)(i).

59. Any provision made other than for the payment of contribution or premium referred to in section 17(1)(h) is not deductible under section 17(1)(j).

60. Where a provision for the payment of any contributions has been allowed in a prior year, the payment subsequently made is not deductible under section 17(1)(k).

61. Any provision made for payment or contribution to retirement schemes, which are not ROR schemes, will not be deductible under section 17(1)(j) and (l).

62. Accounting for retirement schemes is governed by Hong Kong Accounting Standard 19 *Employee Benefits* (HKAS 19) issued by the Hong Kong Institute of Certified Public Accountants. For defined contribution schemes, the accounting and taxation treatments for the contributions are normally straightforward. Ordinary annual contributions or premiums and regular contributions paid and payable for a period will be charged as expenses in the profit and loss account of the period concerned and allowed for taxation purposes, subject to the 15% limit.

63. Accounting for defined benefit schemes is much more complex. Under such a scheme, the employer is responsible for the ultimate payments of scheme benefits to employees as promised, which are usually determined by reference to employees' earnings and years of service. The employer has to bear the actuarial risk (that benefits will cost more than expected) and investment risk of scheme assets. Thus, the cost to the employer of providing the promised retirement benefits cannot be measured by the amounts of contributions currently due alone.

64. HKAS 19 requires that an employer participating in a defined benefit scheme shall recognize the changes in the net defined benefit liability (asset), instead of actual contributions paid, in the accounts. The components of defined benefit cost would be made up of the following:

- (a) service cost (including past service cost and settlement);
- (b) net interest on the net defined benefit liability (asset)<sup>4</sup>; and
- (c) remeasurements of the net defined benefit liability (asset), including actuarial gains and losses recognized in accordance with HKAS 19.

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<sup>4</sup> Interest cost and the expected return on scheme assets are replaced with a measure of net interest on the defined benefit asset or liability in HKAS 19 (2011) issued in July 2011.

As such, the expense recognized for a defined benefit scheme is not necessarily the amount of the contribution due for the period.

65. Having sought legal advice, it was agreed that the defined benefit cost charged in the accounts as required by HKAS 19 is not a provision for payment of ordinary annual contributions to the defined benefit scheme. The defined benefit cost is recognized for accounting purposes as a provision for liabilities incurred when the employer consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

66. Under section 17(1)(j), the defined benefit cost (including the actuarial gains and losses) recognized in the income statement as required by HKAS 19 is not deductible. Where the component is a credit, the amount credited is not taxable as a write-back of over-provision or as a deemed receipt by virtue of section 15(1)(h).

67. As such, the assessing practice for defined benefit schemes is the same as that for defined contribution schemes (i.e. the ordinary annual contributions paid are allowable for deduction, subject to the 15% limit).

68. Retirement schemes established under ORSO have separate legal identities from those of their sponsoring employers. Any losses incurred on the disposal of investments held by ORSO schemes at the time when they are liquidated are not deductible in determining the assessable profits of the employers who established the schemes.

69. On the other hand, costs incurred by an employer in establishing an MPF scheme, amending the rules of an ORSO scheme to comply with the MPF regulations or winding up an ORSO scheme will ordinarily be deductible. Such expenses are regarded as effecting a change on the basis that a business remunerates its employees and not a change in the structure of the business.

## **ASSESSABILITY OF SUMS RECEIVED BY EMPLOYERS**

### ***Refund of contributions to employers***

70. Section 15(1)(h) of the IRO deems sums received by or accrued to a person as an employer, by way of refunds of contributions made to an ROR

scheme or of voluntary contributions paid to an MPF scheme, to the extent deduction has been allowed in ascertaining his assessable profits, to be taxable. Employer's contributions to an ORSO scheme repaid to the employer upon winding up of the scheme are taxable on the employer. Any excess recoupment (being investment income of the ORSO scheme) is not taxable in the hands of the employer.

### ***Offsetting of severance and long service payments***

71. Under the Employment Ordinance, an employer can offset the amount of severance payment or long service payment payable to an employee out of the MPF scheme's accrued benefits derived from the contributions made by the employer for the employee. If the contributions made by the employer exceed the amount of severance/long service payment, the remaining balance has to be retained in the employee's account of the scheme. On the other hand, if the contributions made by the employer cannot fully offset the severance or long service payment, the employer must pay the outstanding balance.

72. Where an employer has paid to an employee severance or long service payment, he may, by virtue of section 12A(1) and (2) of the MPFSO, require the approved trustee of the MPF scheme to pay to him an amount representing the employee's accrued benefit attributable to the employer's contributions not exceeding the amount of the severance or long service payment he paid to the employee. Such a payment to the employer is a refund of the contributions he previously made to the MPF scheme as a result of the reduction of the benefit of the employee as stipulated under section 31IA of the Employment Ordinance. The portion of the refund which is attributable to the voluntary contributions made by the employer is chargeable to tax under section 15(1)(h)(ii) to the extent that it is previously allowed as a deduction in ascertaining the employer's assessable profits. The portion of the refund, which is attributable to the mandatory contributions to the extent that deduction has previously been allowed, should be set-off against the severance payment or long service payment claimed as an allowable deduction.

## **EXEMPTIONS GIVEN TO RETIREMENT SCHEMES**

### ***Recognized retirement schemes***

73. Recognized retirement schemes authorized as collective investment schemes by the Securities and Futures Commission under section 104 of the Securities and Futures Ordinance (Cap. 571) are exempt from profits tax under section 26A(1A)(a) of the IRO.

### ***Non-resident retirement schemes***

74. Prior to 1 April 2019, non-resident retirement schemes were exempt from profits tax if the conditions in section 20AC were satisfied:

- (a) the non-resident retirement scheme did not carry on any trade, profession or business in Hong Kong involving transactions other than the specified transactions and transactions incidental to the carrying out of the specified transaction; and
- (b) the specified transactions were carried out through or arranged by a specified person, or the non-resident retirement scheme was a qualifying fund.

On and after 1 April 2019, non-resident retirement schemes, not falling within the meaning of “fund” in section 20AM, can continue to obtain tax exemption under section 20AC in respect of profits derived from the specified transactions and incidental transactions.

### ***Retirement schemes which are funds***

75. After the enactment of Inland Revenue (Profits Tax Exemption for Funds) (Amendment) Ordinance 2019, effective from 1 April 2019, retirement schemes, which are not exempted under section 26A(1)(a) but falling within the meaning of “fund” in section 20AM, can obtain profits tax exemption subject to meeting conditions set out in section 20AN in respect of profits derived from transactions in assets of a class specified in Schedule 16C and incidental transactions. It should be noted that section 20AM(5)(c) specifically excludes an arrangement in which all participating persons are employees or former

employees of a corporation (or their spouse or children) who are in the same group of the companies as the operator of the arrangement.

## **DEDUCTION ALLOWED TO SELF-EMPLOYED PERSONS**

### ***Mandatory contributions***

76. A self-employed person who is either a sole proprietor or a partner of a partnership is also required to join an MPF scheme. Under section 16AA(1), any mandatory contributions paid in the basis period for a year of assessment are deemed to be expenses wholly and exclusively incurred in the production of profits chargeable to tax of that trade, profession or business and shall be allowed as a deduction in ascertaining the person's assessable profits. However, under section 16AA(2), such deductions cannot exceed the limit specified in Schedule 3B as reduced by any sum allowable under section 26G of the IRO. Provisions in this section override those in section 17(1)(a)(ii) which is applicable to a sole proprietor and section 17(2)(d)(iii) which is applicable to a partner and a partner's spouse. Any sum allowable as a deduction under profits tax will not be allowable for deduction under section 26G.

### ***Voluntary contributions***

77. Voluntary contributions and TVC made to an MPF scheme by self-employed persons are not deductible under section 17(1)(a)(ii) and (2)(d)(iii) as they are expenditure of a private nature and are not incurred in the production of profits chargeable to tax. Likewise, any contributions made to an MPF scheme by a sole proprietor in respect of his or her spouse or by a partnership in respect of a partner's spouse are not allowable under section 17(2)(c) and (d)(iii) respectively. As regards TVC made by a self-employed person on and after 1 April 2019, the concessionary deduction for such contribution would be allowable under section 26S if the self-employed person elects for personal assessment.

### ***Refund of contributions***

78. The provisions in section 15(1)(h) of the IRO, which concern the assessability of refund of contributions, also apply to self-employed persons.

## **ESTATE DUTY**

### ***Exemption provisions***

79. Section 10(h) of the Estate Duty Ordinance (Cap. 111) provides that no estate duty will be payable in respect of accrued benefit passing on the death of a deceased member of an ORSO scheme. Similar exemption provisions have been enacted as section 10(i) in respect of accrued benefit of a deceased member of MPF scheme registered under the MPFSO that are to be paid in accordance with section 15(4) of the MPFSO. With the abolition of estate duty with effect from 11 February 2006, accrued benefit of a deceased who passes away on or after that day will have no estate duty implication at all.

## **REPORTING RESPONSIBILITY OF EMPLOYERS**

### ***Employer's return***

80. It remains the employer's responsibility to report to the Commissioner by way of Employer's Return, among other things, the amount of an employee's gross income from employment (i.e. before deducting any contributions made to a recognized retirement scheme) as well as the taxable amount, if any, of benefits received or taken to have been received by the employee from the scheme.

81. Employers must record and retain, for each employee who migrates from an ORSO scheme to an MPF scheme or from one MPF scheme to another, the details of the employer's contributions included in the voluntary contributions transferred. Where accrued benefits attributable to the employer's contributions are received or taken to have been received (otherwise than on the ground of retirement, death, incapacity, terminal illness or termination of service, whether in a lump sum or (if applicable) as an instalment), employers have an obligation to report the taxable amount received by the employee in the Employer's Return for that year.

## **DOUBLE TAXATION AGREEMENTS**

### ***Pensions article***

82. In negotiation of a double taxation agreement (DTA), Hong Kong generally seeks to obtain exclusive taxation right over payments made out of an MPF scheme. This is achieved if pensions and other similar remuneration (including a lump sum payment) made under a pension or retirement scheme, in which individuals may participate to secure retirement benefits and which is recognized for tax purposes in Hong Kong, are taxable only in Hong Kong. The same result can also be achieved if pensions and other similar remuneration (including a lump sum payment) arising in Hong Kong and paid to an individual in consideration of past employment or self-employment is taxable only in Hong Kong. However, if the taxing right over pensions is shared under a DTA, Hong Kong's tax treaty partner would also have the right to tax the pensions though arising in Hong Kong.

### ***Meaning and situs of pension***

83. The word "pension" in the Pensions Article of a DTA covers a periodic pension and a lump sum pension. To avoid doubt, a lump sum payment is explicitly included. Thus, accrued benefits withdrawn under a recognized retirement scheme, whether by way of a lump sum or instalments, are generally not expected to be taxed by Hong Kong's DTA partner. The source of a pension (i.e. whether a pension is arising in Hong Kong) is the situs of the fund from which the pension is paid. This does not necessarily mean the place where the assets comprising the fund are physically situated but the place where the fund is managed and controlled.