



Inland Revenue Department
Hong Kong

DEPARTMENTAL INTERPRETATION AND PRACTICE NOTES

NO. 28 (REVISED)

PROFITS TAX: DEDUCTION OF FOREIGN TAXES

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 law 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 July 1997.

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Commissioner of Inland Revenue

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THE RULES

Tax on profits or income

For profits tax purposes, all outgoings and expenses not capital in nature, to the extent to which they are incurred in the production of chargeable profits, are allowable for deduction under section 16(1). Since a tax on profits or income is an application of the profits and not an outgoing or expense incurred in producing chargeable profits, the tax is not deductible. The assessable profits of a trade, profession or business are the profits before, and not after, deduction of profits tax.

2. Specifically, section 17(1)(g) provides that no deduction shall be allowed in respect of any tax paid or payable under the Inland Revenue Ordinance (IRO) other than salaries tax paid in respect of employees' remuneration. Equally, foreign taxes on profits or income (e.g. withholding tax on royalties, licensing fees, service fees and management fees), subject to the provisions in section 16(1)(c), are not deductible.

3. In *Attorney General v Ashton Gas Company* [1906] AC 10, it was held that profits ought to be calculated as inclusive, and not exclusive, of the amount payable in respect of income tax. In *Inland Revenue Commissioners v Dowdall O'Mahoney & Co, Ltd* [1952] AC 401, it was held that the tax paid in the Irish Republic was a tax on profits and none of which was expended for the purposes of a trade in the United Kingdom, so that none of it was deductible.

Other taxes and duties

4. While capital gains tax is disallowed as being attributable to capital and not to profits or income, taxes and duties which are not calculated by reference to profits or income will be considered for deduction. These may include:

- (a) rates levied on properties;
- (b) vehicle licence fee;
- (c) duties on commodities; or

- (d) foreign taxes and duties not levied by reference to profits or income, as in *Harrods (Buenos Aires) Ltd v Taylor-Gooby* [1964] 41 TC 450, which concerned an Argentine tax levied on companies at a flat rate of 1 per cent of capital per annum, irrespective of profits or income.

5. Since goods and services tax and value added tax paid in foreign jurisdictions are not in the nature of profits tax or income tax, such taxes will be deductible under section 16(1) if they are incurred in the production of chargeable profits.

SPECIFIED INTEREST AND GAINS

Deduction of foreign taxes on specified interest and gains

6. Section 16(1)(c) allows deduction of tax of substantially the same nature as tax imposed under the IRO, proved to the satisfaction of the Commissioner to have been paid elsewhere other than in a territory outside Hong Kong with which double taxation arrangements (DTA) have been made (DTA territory), whether by deduction or otherwise, by a person who carries on a trade, profession or business in Hong Kong, during the basis period for the year of assessment in respect of profits chargeable to tax by virtue of section 15(1)(f), (g), (i), (ia), (j), (k), (l) or (la).

Unilateral relief restricted to non-DTA territory

7. Section 16(2J) restricts the application of section 16(1)(c). With effect from the year of assessment 2018/19, the unilateral relief from double taxation would not apply in relation to any tax paid in a territory by a person in respect of the profits referred to in section 16(1)(c) if:

- (a) the territory is a DTA territory; and
- (b) under section 50, tax payable in the territory by a Hong Kong resident person in respect of the profits is to be allowed as a credit against tax payable in Hong Kong by the Hong Kong resident person in respect of the profits.

Hence, section 16(1)(c) would not be applicable if the foreign tax is paid in a DTA territory and under the DTA with that territory, relief from double taxation is provided by way of credit under section 50.

Example 1

For the year of assessment 2018/19, Bank-HK paid an income tax in Jurisdiction-F in respect of the interest income received. The interest income was chargeable to profits tax under section 15(1)(i). No DTA has been entered into between Hong Kong and Jurisdiction-F.

Income tax paid in Jurisdiction-F would be deductible under section 16(1)(c) since Jurisdiction-F was not a DTA territory.

Reasons for enacting section 16(2J)

8. The reason for denying a deduction under section 16(1)(c) is that a DTA is intended to provide a comprehensive solution to all tax matters which are within its scope. The international practice is that where a DTA is in place, relief from double taxation should be allowed under the DTA only to the extent contemplated by it. The tax credit approach is adopted by Hong Kong in all existing DTAs. Section 16(2J) seeks to ensure that the DTAs will prevail in case of any conflicts between the provisions in the IRO and those in the DTAs. Therefore, if the foreign tax is paid in a DTA territory and the relevant DTA provides relief from double taxation by way of tax credit, a Hong Kong resident person can only apply for a tax credit under section 50. For a non-Hong Kong resident person who is not covered by the relevant DTA, it may seek unilateral relief from its residence of jurisdiction or bilateral relief under the DTA between its residence jurisdiction and the DTA territory (if any).

Example 2

Same facts as in Example 1 but Hong Kong has entered into a DTA with Jurisdiction-F.

Income tax paid in Jurisdiction-F would not be deductible under section 16(1)(c) by virtue of section 16(2J). If Bank-HK is a Hong Kong resident person, it may claim a tax credit under section 50.