

Digital Economy & Defining Taxable Presence – Hong Kong

AOTCA International Tax Conference

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Digital economy – tax issues



Digital economy – Hong Kong profits tax

- ▶ According to section 14 of the Inland Revenue Ordinance (IRO), profits tax shall be charged on a person if **all** the following three conditions are satisfied:
 - ▶ the person is carrying on trade, profession or business in Hong Kong;
 - ▶ the profits to be charged are derived from such trade, profession or business; and
 - ▶ the profits are arising in or derived from Hong Kong.
- ▶ No specific tax legislation dealing with e-commerce in the IRO.

Digital economy – Hong Kong profits tax

- ▶ Departmental Interpretation and Practice Notes No. 39: Profits Tax – Treatment of Electronic Commerce (DIPN 39) issued by the Inland Revenue Department (IRD).
- ▶ DIPN 39 is issued for the information and guidance of taxpayers and their authorized representatives. They have no binding force and do not affect a person's right of objection or appeal to the Commissioner, the Board of Review or the Courts.
- ▶ Issued in July 2001

Digital economy – Hong Kong profits tax

▶ DIPN 39

- ▶ The IRO applied to e-commerce on the same basis as to conventional forms of business.
- ▶ No particular business form should have either an advantage or a disadvantage as far as taxation concerned.
- ▶ More appropriate to focus on the broad taxation principles that currently apply to e-commerce generally, and are likely to continue to do so in the future.
- ▶ IRD's practices in relation to e-commerce and the suitability of our taxation legislation will be reviewed in the light of developments. DIPN 39 will be updated as and when the need arises.

Digital economy – Hong Kong profits tax

- ▶ **The person is carrying on trade, profession or business in Hong Kong (Condition 1)**
 - ▶ Extensive activities are not necessarily required before it can be said that a person is carrying on a trade or business.
 - ▶ In the case of a company incorporated for the purpose of making profits for its shareholders any gainful use to which it puts any of its assets prima facie amounts to the carrying on of a business. (*American Leaf Blending Co. Sd Bhd v Director General of Inland Revenue [1978] STC 561*)
 - ▶ Not every gainful use of a company's assets would necessarily lead to the conclusion that a trade or business is being carried on.

Digital economy – Hong Kong profits tax

- ▶ Many different factors may be relevant in determining whether a person engaged in e-commerce is carrying on a trade or business in Hong Kong:
 - ▶ places where goods are stored and delivered by the person, services are provided, payments are made and received, purchases and sales are made, bank accounts are maintained, and business back-up services etc.
- ▶ Mere presence of a server in Hong Kong (even if an intelligent one capable of concluding contracts, processing payments or delivering digital goods), without the involvement of human activities here would not generally amount to the carrying on of a business in Hong Kong.

Digital economy – Hong Kong profits tax

- ▶ **The assessable profits are arising in or derived from Hong Kong (Conditions 2 and 3)**
 - ▶ Need to ascertain what were the taxpayer's operations which produced the relevant profits and where those operations took place.
 - ▶ The place where the automated server-based activities are carried out does not, of itself, determine the locality of profits
 - ▶ Have to be weighed against the core business operations required to conduct the e-commerce transactions.
 - ▶ Generally the location of the physical business operations, rather than the location of the server alone, that determines the locality of the profits.

Digital economy – Hong Kong profits tax

- ▶ The assessable profits are arising in or derived from Hong Kong (Conditions 2 and 3)
- ▶ Example:

HK

- ▶ Enable customers (local and overseas) to obtain details of products and price lists
- ▶ Process purchase orders and payments
- ▶ Allow the downloading via the internet of products which are available in a digitized format

Overseas

- ▶ Procurement of products
- ▶ Supply of information for the server
- ▶ Storage of products
- ▶ Physical delivery of products
- ▶ Answering of customers' enquiries
- ▶ Operational controls of the virtual shop-front)



Digital economy – Hong Kong withholding tax

- ▶ According to Sections 15(1)(b) /(ba) and 21A of the IRO:
 - ▶ sums received by or accrued to a person
 - ▶ for the use of or right to use in HK [15(1)(b)] / for the use of or right to use outside HK where such payment is tax deductible [15(1)(ba)]
 - ▶ any such patent, design, trademark, **copyright**, secret process or formula or other property
 - ▶ withholding tax rate: 3% / 4.95% / 16.5%

Acquisition of computer software or other digital products	
For the use of / right to use the copyright which subsists in the software program	For the use of / right to use only the actual software program
Make copies for distribution to the public; the right to prepare derivative programs; the right to make a public performance of the program and the right to publicly display the program	Simple use of the software
Section 15(1)(b) / (ba) applies	Section 15(1)(b) / (ba) does not apply

Digital economy – international tax environment

▶ DIPN 39

- ▶ IRD's practices in relation to e-commerce and the suitability of our taxation legislation will be reviewed in the light of developments. DIPN 39 will be updated as and when the need arises.

▶ Consider implications of Base Erosion and Profit Shifting (BEPS) – Action 1: Tax Challenges of the Digital Economy

- ▶ Double non-taxation
- ▶ Counter harmful tax practice

Digital economy – tax issues



Question and answer



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