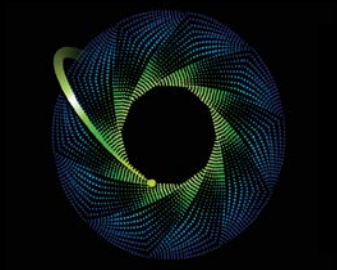
Deloitte. 德勤



Hong Kong Tax Newsflash

Tax matters clarified in the 2025 annual meeting between the IRD and HKICPA

Hong Kong | Tax & Business Advisory | 2 April 2026 | Issue 263

The minutes of the annual meeting between the Inland Revenue Department (IRD) and the Hong Kong Institute of Certified Public Accountants (HKICPA) held in 2025 were recently released. The minutes set out in-depth discussions on a range of current tax issues. This article highlights the key topics discussed in the meeting.

1. Foreign-sourced income exemption (FSIE) regime

(a) Asymmetric treatment of interest income and interest expense

(i) Offshore claim on interest income

There has been concern that carrying out specified economic activities in Hong Kong to meet the economic substance requirement (ESR) under the FSIE regime may undermine the offshore claim for interest income, which is increasingly determined by operations test[1].

The IRD reaffirmed that the determination of the source of profits and compliance with the ESR under the FSIE regime are separate matters and will be assessed in independent contexts. The ESR should not, by itself, affect the source of profits.

Holding meetings in Hong Kong solely for making strategic decisions (e.g. type of borrowers, short-term or long-term loans) to satisfy the ESR would not necessarily undermine the offshore claim for interest income, as long as the profit-generating activities that put the loan in place for earning interest income, such as sourcing funds or negotiating loan terms with the borrower, are conducted outside Hong Kong.

It is further clarified that holding a board meeting to discuss general matters would not be sufficient to satisfy the ESR. The ESR would only be met if strategic decisions relating to the FSIE subject matter were made during the meeting. Outsourcing of specified economic activities by an MNE entity to an outsourced entity (e.g. a secretarial firm) in Hong Kong is permitted for satisfying the ESR, provided that adequate monitoring and control are exercised.

(ii) Deductibility of interest expense

Where offshore interest income becomes taxable under the FSIE regime, the related interest expense may be deductible in the year the income is received in Hong Kong, subject to the interest deduction rules. However, the interest deduction rules remain stringent. For example, a Hong Kong company that

[1] Operations test is used to determine the source of interest income where the subject matter is not a simple loan of money.

borrows from an overseas group entity to fund a one-off loan may generate offshore interest income that becomes taxable under the FSIE regime, yet it is unable to claim a deduction for the interest expense, as the lending of a one-off loan typically does not constitute carrying on an "intra-group financing business".

The HKICPA urged the IRD to review the interest deduction rules. While the IRD acknowledged these concerns, it confirmed there are no immediate plans to amend the existing rules, as any change would require strong policy justification and appropriate safeguards to prevent tax avoidance. However, it indicated that targeted enhancements, similar to existing concessions for aircraft leasing and intra-group financing businesses, could be explored for certain industries or business activities.

(b) Filing of profits tax return in respect of non-resident persons (BIR Form 54)

Under the Inland Revenue Ordinance, sums received by or accrued to a person for the use, or the right to use, certain intellectual property (IP) outside Hong Kong, where the corresponding expense is deductible in ascertaining assessable profits, are deemed to be a taxable trading receipt. The Hong Kong payer is required to file BIR Form 54 and withhold tax on behalf of the non-resident recipient.

A Hong Kong taxpayer derived offshore royalty income from a sublicensing arrangement but failed to qualify for FSIE. When the income became taxable in a later year (i.e. in the year of receipt), the taxpayer claimed a deduction of the relevant royalty expense paid to the non-resident IP owner, thereby triggering the deemed taxable trading receipt rule.

The IRD confirmed that the year of receipt is the relevant year of assessment for both the taxpayer and the non-resident IP owner. The taxpayer is required to inform the IRD of the chargeability of the non-resident's royalty income and to file BIR Form 54 on behalf of the non-resident for that year.
For ease of compliance and subject to the taxpayer's agreement, the IRD indicated it could explore an administrative arrangement allowing taxpayers to assess such income in the year of accrual to align with the payment timing.

2. Deduction of reinstatement costs

Starting from the year of assessment 2024/25, reinstatement costs incurred for premises under a lease are deductible, subject to the following conditions:

- The person claiming the deduction is a lessee under the lease;
- The lessee has a reinstatement obligation for the premises;
- The reinstatement costs have been actually incurred (i.e. not merely provided for under accounting standards); and
- The amount of the reinstatement costs is reasonable.

(a) Utilization of provisions for reinstatement costs (2024/25 onwards)

The IRD confirmed that where a provision for reinstatement costs was previously treated as non-deductible, the actual costs incurred or paid in the year of assessment 2024/25 or thereafter will be deductible, provided all other conditions are satisfied.

(b) Group recharge arrangements

Where a group holding company enters into a tenancy agreement with a landlord and recharges rental and reinstatement costs to other group entities, the IRD considers the holding company as the lessee and the party bearing the reinstatement obligation, and therefore eligible to claim the deduction.

In the absence of a lease agreement, group entities, even participating in cost sharing arrangements, are not regarded as lessees and cannot claim deductions for reinstatement costs. The IRD also clarified that a cost sharing agreement (CSA) does not constitute a lease agreement, and costs charged under a CSA are not allowed as reinstatement costs.

However, such recharges may be regarded as intra-group service fees and deductible under the general deduction rule, provided they were incurred in the production of assessable profits and charged on an arm's length basis.

3. Certificate of resident status (CoR)

(a) Bulk applications for CoR under STA Circular 2018 No. 9 (PN 9)

A CoR issued under the double tax arrangement (DTA) between the Chinese Mainland and Hong Kong is valid for 3 calendar years. The IRD does not accept applications for Year 2 or Year 3 if a valid CoR has already been issued for Year 1.

On the same basis, the IRD clarified that bulk applications for Hong Kong CoRs under PN 9[2] will not be entertained where some group entities already hold valid CoRs within the three-year period, as this would lead to confusion with the State Taxation Administration. Taxpayers must apply separately when the existing CoRs expire.

However, the IRD may consider exceptional cases where the Chinese Mainland tax authority specifically requests a new CoR for Year 2 or Year 3. In such cases, the applicant must set out the reasons and circumstances of the request in the application.

(b) CoR for disposal gains

While CoRs are generally issued only when income has arisen, the IRD is prepared to consider early applications for disposal gains, provided there is reasonable certainty that the income will arise in the relevant year. Such applications must be supported by documentary evidence, such as a sale and purchase agreement or memorandum of understanding. Mere assertions that gains are expected, without proof, will not be accepted.

(c) CoR for non-DTA purposes

The IRD reiterated that CoRs are issued only for DTA purposes.

No CoR will be issued for the purposes of the Global Anti-Base Erosion (GloBE) rules under Pillar Two, as there is currently no requirement to use a CoR to prove tax residence under the GloBE rules. Similarly, CoRs will not be issued for compliance with economic substance legislation in no- or nominal-tax jurisdictions, nor for re-domiciled companies for non-DTA purposes.

[2] PN 9 provides for how the "beneficial owner" test is applied to claim tax benefits on dividends, interest and royalties under the DTA between Chinese Mainland and Hong Kong / other jurisdictions and introduces a look-through rule for a multi-level holding structure. The IRD allows persons in a multi-level holding structure who required CoRs for the purposes of PN 9 to submit their CoR applications in a bundle.

4. Transfer pricing

(a) Transfer pricing rules in the context of GloBE rules and Hong Kong minimum top-up tax (HKMTT)

Domestic transactions that do not confer a potential advantage in relation to Hong Kong tax are exempt from the arm's length principle. This includes transactions that do not give rise to actual tax difference.

The IRD clarified that top-up taxes imposed under the GloBE rules and HKMTT are excluded from the definition of "Hong Kong tax" for transfer pricing purposes. As a result, these taxes are not considered when assessing whether a transaction provides a tax advantage or satisfies the "no actual tax difference" condition for exemption.

(b) Country-by-country (CbC) Reporting in demerger case

A multinational enterprise (MNE) group is required to file a CbC Report if its consolidated group revenue in the preceding accounting period exceeds EUR750 million (or HKD 6.8 billion) and it has constituent entities or operations in two or more jurisdictions.

In demerger scenarios, the IRD confirmed that Hong Kong will adopt Approach 2[3] under OECD guidance. Under this approach, if a Hong Kong entity and its subsidiaries (previously under Group A) are sold and become an independent group (Group B) in year 1, Group B would be regarded as already existed in year 0 for CbC Reporting purposes. It will be required to file a CbC report for year 1 if its consolidated revenue in year 0 met the revenue threshold, even though it did not legally exist as an independent group in year 0.

However, the IRD emphasized that the filing obligation depends on the approach adopted by the residence jurisdiction of the ultimate parent entity. If the MNE group is a Hong Kong group, the ultimate parent entity is required to notify the IRD and comply with the CbC Reporting under Approach 2. Conversely, if the MNE group's ultimate parent entity is located in a jurisdiction adopting Approach 1[4], the Hong Kong constituent entity is not required to file a CbC report in Hong Kong for year 1.

(c) Supplementary Form S2

Section 4 of Supplementary Form S2 must be completed by constituent entities of MNE groups with consolidated group revenue of at least EUR 750 million in the preceding accounting period.

For groups preparing consolidated financial statements in non-Euro currencies, the IRD clarified that the relevant amounts should be converted using the published spot rate on the accounting period end date, based on the Euro foreign exchange reference rates published by the European Central Bank.

The IRD highlighted that Supplementary Form S2 will be revised to align with the GloBE revenue threshold. Exchange rate information will be published on the IRD's dedicated webpage in due course.

[3] The OECD provided two approaches for determining whether CbC Reporting is required for demerger cases. Approach 2 regards the demerged group already existed before the sale.
[4] Approach 1 regards the demerged group did not exist legally as an independent group before the demerger.

5. Special sectors

(a) Family-owned Investment Holding Vehicles (FIHVs)

To qualify for tax concessions under the single family office regime, the aggregate net asset value (NAV) of Schedule 16C assets managed by an eligible single family office for FIHVs must be at least HKD 240 million.

The IRD clarified that NAV generally means total assets minus total liabilities. Accordingly, loans (including shareholder's loan) must be deducted from the total asset value when calculating the NAV of the Schedule 16C assets, unless the loan can be classified as equity[5] in accordance with the accounting standard.

The IRD explained that this reflects the policy intent to ensure that eligible single family offices bring genuine net assets into Hong Kong without relying on borrowing.

(b) Charitable institutions

While charities may carry out charitable activities anywhere in the world, profits are exempt from profits tax only if they are not expended substantially outside Hong Kong.

For example, profits derived from educational courses provided in Hong Kong (assuming this constitutes a trade carried out in the course of the charity's objects) and used to build a school in the Chinese Mainland would not qualify for exemption. However, if the educational courses are provided outside Hong Kong, the profits would be offshore sourced and non-taxable, even if they do not qualify for charitable exemption.

The IRD emphasized that whether an activity constitutes a trade or business is a question of fact and degree. An activity organised in a systematic way may be regarded as carrying on a trade. Fund-raising activities such as selling flags or lottery tickets at a street booth would generally not be considered trading. Similarly, if a charity invests surplus cash in listed shares as long-term investments or in interest-bearing time deposits, such activities are unlikely be regarded as carrying on a trade.

Our observation

While the views expressed in the meeting minutes between the IRD and the HKICPA are not legally binding, they provide valuable insights into the IRD's stance on various tax issues. These discussions have significant implications for taxpayers and practitioners, and it is essential to be aware of the key points to ensure compliance and optimize tax planning.

Regarding the FSIE regime, the IRD's clarification of the distinction between profits-generating activities (relevant for source determination) and specified economic activities (required for ESR) provides useful guidance. To enhance certainty, we suggest that the IRD publish further guidelines with practical examples on its website, illustrating how compliance with the ESR would not, in itself, undermine the offshore nature of interest income under the operations test.

At the same time, the persistence of asymmetric treatment between interest income and interest expense continues to create distortions that may discourage the use of Hong Kong as a financing hub. While the IRD has no immediate plans to revise the existing interest deduction rules, it is encouraging that it remains open to exploring targeted enhancements for specific industries and business activities.

[5] Under HKAS 32, a loan could be classified as an equity if it did not have a contractual obligation to repayment (e.g. a perpetual loan without a maturity date); or it would or might be settled by the issuer's own equity (e.g. convertible loan which converted into shares after a certain period).

For FIHVs, the IRD clarified that NAV must be calculated as total assets minus total liabilities, with shareholder loans treated as liabilities unless classified as equity. This interpretation may reduce eligibility for concessions. While the IRD acknowledged industry concerns and committed to passing feedback to the Financial Services and the Treasury, there is currently no proposal to amend this requirement in the latest proposal to enhance the single family office tax regime. We hope the government could consider a more pragmatic approach when drafting the relevant legislation.

On the compliance side, it is welcomed to see the IRD's willingness to explore accrual-based assessment for offshore royalty income and to consider early CoR applications in disposal gain scenarios. These initiatives reflect a pragmatic approach to easing compliance burdens and demonstrate responsiveness to taxpayer needs.

Taxpayers and practitioners should review these discussions to ensure their tax strategies are aligned with the IRD's interpretations and to identify any necessary adjustments to their financial and operational structures.

Authors

Doris Chik
Tax Partner
+852 2852 6608
dchik@deloitte.com.hk

Carmen Cheung
Senior Tax Manager
+852 2740 8660
carmcheung@deloitte.com.hk

Kiwi Fung
Tax Manager
+852 2258 6162
kifung@deloitte.com.hk

For more information, please contact:

Tax & Business Advisory Southern Region Leader
Jennifer Zhang
Tax Partner
+852 2258 6228
jennifzhang@deloitte.com.hk

Hong Kong Leader
Anthony Lau
Tax Partner
+852 2852 1082
antlau@deloitte.com.hk

About Deloitte

Deloitte China provides integrated professional services, with our long-term commitment to be a leading contributor to China's reform, opening-up and economic development. We are a globally connected firm with deep roots locally, owned by our partners in China. With over 20,000 professionals across 31 Chinese cities, we provide our clients with a one-stop shop offering world-leading audit, tax and consulting services.

We serve with integrity, uphold quality and strive to innovate. With our professional excellence, insight across industries, and intelligent technology solutions, we help clients and partners from many sectors seize opportunities, tackle challenges and attain world-class, high-quality development goals.

The Deloitte brand originated in 1845, and its name in Chinese (德勤) denotes integrity, diligence and excellence. Deloitte's global professional network of member firms now spans more than 150 countries and territories. Through our mission to make an impact that matters, we help reinforce public trust in capital markets, enable clients to transform and thrive, empower talents to be future-ready, and lead the way toward a stronger economy, a more equitable society and a sustainable world.