HKSAR Government responds to inclusion of Hong Kong in EU’s watchlist on tax co-operation

The European Union (EU) today (October 5) announced the inclusion of Hong Kong in its watchlist on tax co-operation as it considered that the non-taxation of certain foreign sourced passive income in Hong Kong might lead to situations of "double non-taxation". The Government of the Hong Kong Special Administrative Region (HKSAR) responded to media enquiries on the announcement.

"As an international financial centre, Hong Kong has all along been actively participating in and supportive of international tax co-operation. Over the years, Hong Kong has adopted the territorial source principle of taxation, whereby offshore profits are generally not subject to profits tax in Hong Kong," a Government spokesperson said.

The EU is concerned that corporates with no substantial economic activity in Hong Kong are not subject to tax in respect of certain offshore passive income (such as interest and royalties), hence leading to circumstances of "double non-taxation". Under the premise of supporting the combating of cross-border tax evasion, the HKSAR Government agrees to co-operate with and has committed to the EU to amend the Inland Revenue Ordinance (Chapter 112 of the Hong Kong laws) by the end of 2022 and implement relevant measures in 2023.

The Government spokesperson stressed, "Hong Kong will continue to adopt the territorial source principle of taxation. The Government will endeavour to uphold our simple, certain and low-tax regime with a view to maintaining the competitiveness of Hong Kong's business environment.

"The proposed legislative amendments will merely target corporations, particularly those with no substantial economic activity in Hong Kong, that make use of passive income to evade tax across a border. Individual taxpayers will not be affected. As to financial institutions, their offshore interest income is already subject to profits tax under the Inland Revenue Ordinance at present, and hence the legislative amendments will not increase their tax burden.

"We will consult the stakeholders on the specific contents of the legislative amendments and strive to minimise the compliance burden of corporates."

The EU published the guidance on the foreign sourced income exemption regime in October 2019 and commenced corresponding assessment on the tax arrangements of a number of tax jurisdictions (including Hong Kong). The focus of the assessment is to address situations where offshore shell companies obtain tax benefits through "double non-taxation". The HKSAR

Government has been in contact with the EU on its assessment and has been actively engaging with the EU on the follow-up work.

The spokesperson said, "Hong Kong enterprises will not be subject to defensive tax measures imposed by the EU as a result of being included in the watchlist on tax co-operation. The HKSAR Government will request the EU to swiftly remove Hong Kong from the watchlist after amending the relevant tax arrangements."