Hong Kong Tax Alert

23 May 2025
2025 Issue No. 9

IRD explained how it would interpret the law and its assessing practice relating to individual tax issues in the minutes[1] of its 2024 annual meeting with the HKICPA

- *including (i) a tax assessment on share awards could be revised under a late objection if the awards were subsequently clawed back;*

- *(ii) where an individual rendered services in Hong Kong under an employment, whether and how much of the leave pay of the individual was attributable to their services rendered inside or outside Hong Kong would be fact specific;*

- *(iii) rents paid under the tenancy of a serviced apartment would qualify for the domestic rents expense deduction if the tenancy was a stamped lease agreement but not a license agreement that was not chargeable to stamp duty in Hong Kong; and*

- *(iv) tax residence of Hong Kong of an individual under a comprehensive avoidance of double taxation agreements or arrangement (CDTA) could be determined based on either (a) the ordinary residence test or (b) the 180/300-day physical presence test.*

While the Inland Revenue Department's (IRD) above explanation provides some general guidance on how the tax provisions would be interpreted and the assessing practice would work, their application would still be fact specific. Clients who have any questions on the above should contact their tax executive.

[1] The minutes of the 2024 annual meeting can be retrieved from the link below:
https://www.hkicpa.org.hk/-/media/Document/APD/TF/Tax-bulletin/035_May-2025.pdf

Revising a tax assessment on share awards subsequently clawed back

Hong Kong Institute of Certified Public Accountants' (HKICPA) question

The following example was used by the HKICPA to raise the question of whether a tax assessment on share awards could be revised if the awards were subsequently clawed back under the terms of a share award plan.

Example

A company had a share award plan. In 2022/23, the company issued shares for nil consideration to an employee under the plan. The employee obtained legal ownership and the economic benefits of the shares in 2022/23. The income in respect of the shares was reported and taxed in 2022/23.

(i) Subsequently in 2023/24, a material restatement of the company's financials for prior years needed to be made. Therefore, the company clawed back all the shares issued to the employee in 2022/23 for nil consideration, under the terms of the share award plan.

(ii) Same as (i) above except that in 2023/24, the employee ceased employment and joined a competitor, so the company clawed back all the shares under the terms of the share award plan.

IRD's reply

The IRD responded that the tax treatment on clawback of share awards would depend on the peculiar facts and circumstances of individual cases, having regard to the specific terms and conditions of the share award plans. In general, when the clawback condition occurred and on the assumption that a tax avoidance scheme was not involved, it could be accepted that the share benefits previously chargeable were subject to a contingency of the occurrence of the claw back condition. Such a condition would have a bearing upon the actual amount of income which should be brought to charge.

Legal basis for revising the assessment

The IRD indicated in both scenarios (i) and (ii) above, where the employee returned the granted/vested share benefits to the employer, the value of which had been assessed to tax in 2022/23, the employer could file a revised employer's return for the year of assessment 2022/23. The revised employer's return reporting the correct amount of income accrued to the employee should be accompanied with a statement explaining the situation giving rise to the correction.

The employee could, on the other hand, request the IRD to revise the assessment for the year 2022/23 under a late objection. That meant requesting the Commissioner to extend the normal one-month time limit for raising an objection under section 64(1)(a) of the Inland Revenue Ordinance (IRO) on the grounds that there were reasonable causes for the delay. That the clawback could not be anticipated would constitute a reasonable cause. Such a notice of objection should be filed within a reasonable time, say within one month from the clawback.

The IRD added that both in scenarios (i) and (ii) the employee would not be able to rely on section 70A of the IRO to re-open the assessment since there was no error involved.

Dividends or bonus shares not subject to repayment under clawback

Regarding dividends or bonus shares received by a taxpayer, which were not subject to repayment to the employer upon clawback, the IRD indicated that how the assessment would be revised depended on the facts and circumstances of the case and whether they had been assessed previously. For example, whether the dividends would be assessed depended on whether the upfront or back-end approach was used. If the taxpayer had been assessed previously and the taxpayer was not required to return the dividends when the share awards were clawed back, the dividend income should not be excluded from the assessment.

The IRD added that under the back-end approach, dividends received by a taxpayer during the vesting period of a share award plan would be taxable income because at that time the shares had not yet vested on the employee. Accordingly, the dividends received were not truly dividends but rather a form of employment income in the nature of dividend equivalents.

The IRD also indicated that Departmental Interpretation and Practice Notes No. 38 (Revised) in respect of Salaries Tax Employee Share-based Benefit would be updated.

How leave pay attributable to services rendered inside or outside Hong Kong be ascertained

The questions raised by the HKICPA were based on two cases, namely (i) *Commissioner of Inland Revenue v Lo Wa Ming Patrick* [2022] 2 HKLRD 1162 of the Court of Appeal and (ii) the tax tribunal of the Board of Review (BOR) case, D18/22.

Commissioner of Inland Revenue v Lo Wa Ming Patrick

The taxpayer in this case was under a Hong Kong employment and was seconded to work in an associated company of the employer in Guangdong. During the secondment period, while remaining under the Hong Kong employment, he occasionally came back to Hong Kong to render services to his employer and did not qualify for the "60-days tax exemption condition" under section 8(1B) of the IRO. The taxpayer spent most of his weekends and leave days in Hong Kong during the secondment period.

As such, while the whole of his employment income was chargeable to Salaries Tax in Hong Kong for the year of assessment 2014/15, the taxpayer also paid tax in respect of the same income in mainland China.

In calculating the amount of income that could be excluded from the tax assessment in Hong Kong under section 8(1A)(c) of the IRO, the IRD only excluded the income attributable to the taxpayer's work days in mainland China[2]. Thus, none of his leave pay was excluded from the tax assessment in Hong Kong.

On appeal, the Court of Appeal held, based on the facts of the case, the part of the leave pay that was attributable to the services rendered by the taxpayer in mainland China should also be excluded from the tax assessment. Such an attribution would be made on the day-in-day-out (DIDO) time-apportionment basis, i.e., the ratio of the number of work days in mainland China to the number of total work days during the period concerned.

BOR case D18/22

The taxpayer in this case entered into a dual contract arrangement with his employer group, i.e.(i) a Hong Kong employment contract with a group company in Hong Kong and (ii) a non-Hong Kong employment contract with a group company located a foreign jurisdiction.

During the period concerned, while spending most of his time in Hong Kong to work for his Hong Kong employer, he also spent some time in the foreign jurisdiction to work for the overseas group company.

The BOR rejected the Commissioner's argument that there was in reality only one Hong Kong employment and the dual contract arrangement was caught by the anti-avoidance provisions in sections 61 and 61A and therefore should be disregarded. The BOR found that the dual contract arrangement did comprise two separate employment contracts that were commercially justifiable.

Given that the taxpayer spent most of his time in Hong Kong, the BOR considered that part of the income from his non-Hong Kong employment should also be chargeable to tax in Hong Kong under section 8(1A)(a) of the IRO.

However, in ascertaining the "income derived from services rendered in Hong Kong including leave pay attributable to such services" under section 8(1A)(a) of the taxpayer under the non-Hong Kong employment, the BOR departed from the usual DIDO time-apportionment basis.

The departure included scaling down the amount ascertained under the DIDO time-apportionment basis by the ratio of (i) the non-Hong Kong employment income to the aggregate of (i) the non-Hong Kong employment income and (ii) the Hong Kong employment income.

The scaling down was apparently made based on the premises that for any one work day he was in Hong Kong, the taxpayer would need to devote his time partly to the non-Hong Kong employment and partly to the Hong Kong employment.

Question raised by the HKICPA

The question raised by the HKICPA was whether the IRD would follow the decision of these two cases in similar situations.

[2] Note that the section 8(1A)(c) exclusion would only now be applicable where tax suffered in a foreign jurisdiction is in respect of services rendered in the jurisdiction and the jurisdiction does not have a CDTA with Hong Kong. Where the jurisdiction is a CDTA-jurisdiction, taxpayer would now only be able to claim a foreign tax credit in Hong Kong in respect of the tax paid in the overseas jurisdiction under the CDTA concerned.

IRD's reply

The IRD responded that section 8(1A)(a) of the IRO extended the basic charge in section 8(1) to catch income "derived from services rendered in Hong Kong" in the case of a non-Hong Kong employment. Although there was no provision in the IRO or set law to specify the basis for apportioning income under section 8(1A)(a) of the IRO, it had been the IRD's established practice to use the DIDO time-apportionment basis to compute the amount of income chargeable to tax under that provision. The exact formulation adopted under the DIDO time-apportionment basis could differ based on the circumstances of individual cases.

The IRD however considered that decision in D18/22 was fact specific. In general, the IRD would continue to adopt the DIDO time-apportionment basis for determining the amount of income attributable to services in Hong Kong under section 8(1A)(a) unless it could be proved that another basis or further modification was justified having regard to the facts and circumstances of the case. Having said that, with reference to the *Lo Wa Ming Patrick* case, the IRD would also accept the following specific formula under the DIDO for the purpose of section 8(1A)(a).

$$\text{Income} \times \frac{\left[\text{Working days in Hong Kong}\right] + \left[\text{Leave days and rest days (Note 1) attributable to services rendered in Hong Kong (Note 2)}\right]}{\text{Total calendar days}}$$

Notes:
1. Rest days meant Saturdays, Sundays and public holidays.
2. Leave days and rest days attributable to services rendered in Hong Kong were calculated as follows:

$$\text{Total leave days and rest days} \times \frac{\text{Calendar days (excluding leave days and rest days) in Hong Kong}}{\text{Total calendar days} - \text{Total leave days and rest days}}$$

The IRD stated that when a taxpayer claimed dual employment for similar services, the IRD would assess whether the situation truly constituted two separate employments. If it could be established that there two employments, the IRD would review the terms of those employments and the manner in which the services were provided to ascertain the apportionment basis for apportioning income under section 8 of the IRO.

Only rents paid for the tenancy of a serviced apartment under a stamped lease agreement would qualify for the domestic rents expense deduction

The question raised by the HKICPA was whether the tenancy of a serviced apartment in the form of an unstamped license agreement would qualify for the domestic rents expense deduction.

The IRD responded that under section 26X of the IRO, only rents paid under a qualifying tenancy of any domestic premises would be deductible. "Qualifying tenancy" was defined in section 26W of the IRO in relation to any domestic premises to mean a tenancy in writing in respect of the right to the exclusive use of the premises that was, except for government lease, stamped within the meaning of the Stamp Duty Ordinance (SDO).

As a license agreement did not confer the right to exclusive use of or the proprietary interest in the property (thereby creating no landlord-and-tenant relationship) and is not an instrument chargeable to stamp duty under the SDO, it did not fall within the meaning of "qualifying tenancy". Hence, the rents paid under a license agreement in respect of a serviced apartment were not allowable for deduction.

The IRD added that the law imposed no restriction on the types of domestic premises that were leased for residential purpose and did not exclude serviced apartments from the tax deduction regime. If a serviced apartment was leased rather than licensed under a qualifying tenancy for residential use and the lease agreement was stamped, the rents paid under the tenancy would qualify for deduction.

Tax residence of Hong Kong of an individual be determined on either the ordinary residence test or the 180/300-day physical presence test

The IRD confirmed that it had all along taken the view that the ordinary residence test and the 180/300-day physical presence test were two alternative tests for determining whether an individual was a Hong Kong resident for tax purposes. In this regard, an individual who did not meet the 180/300-day physical presence test might still be regarded as a Hong Kong resident if he met the ordinary residence test.

It was well-established that the question of ordinary residence was one of fact and degree. In this regard, the IRD would take into account all relevant factors and give them such weight as was appropriate in the overall circumstances of the case. Apart from the number of days that the individual was physically present in Hong Kong, other factors to be considered might include whether the individual habitually and normally resided in Hong Kong with some degree of continuity, the nature, duration and reasons of his absence from Hong Kong, where his family members lived, and whether he had any social and economic ties with Hong Kong. What were the relevant factors and how much weight was to be given to each of them would depend on the actual circumstances of each case. That said, if the number of days of an individual's presence in Hong Kong in a year was minimal, and the reason for his absence (e.g., emigration) clearly suggested that Hong Kong was no longer adopted as his place of residence for a settled purpose as part of the regular order of his life, these were strong indicia that the individual could not be regarded as still ordinarily residing in Hong Kong.

While the IRD's above explanation provides some general guidance on how the tax provisions would be interpreted and the assessing practice would work, their application would still be fact specific. Clients who have any questions on the above should contact their tax executive.

Hong Kong office

Jasmine Lee, Managing Partner, Hong Kong & Macau
27/F One Taikoo Place, 979 King's Road, Quarry Bay, Hong Kong
Tel: +852 2846 9888 Fax: +852 2868 4432

Non-financial Services

Wilson Cheng
Tax Leader for Hong Kong and Macau
+852 2846 9066
wilson.cheng@hk.ey.com

Business Tax Services/Global Compliance and Reporting

Hong Kong Tax Services

Wilson Cheng
+852 2846 9066
wilson.cheng@hk.ey.com

Jacqueline Chow
+852 2629 3122
jacqueline.chow@hk.ey.com

Ryan Dhillon
+852 3752 4703
ryan.dhillon@hk.ey.com

Tracy Ho
+852 2846 9065
tracy.ho@hk.ey.com

Ada Ma
+852 2849 9391
ada.ma@hk.ey.com

Jennifer Kam
+852 2846 9755
jennifer.kam@hk.ey.com

May Leung
+852 2629 3089
may.leung@hk.ey.com

Karina Wong
+852 2849 9175
karina.wong@hk.ey.com

Leo Wong
+852 2849 9165
leo.wong@hk.ey.com

Ricky Tam
+852 2629 3752
ricky.tam@hk.ey.com

Susan Kwong
+852 2629 3117
susan.tm.kwong@hk.ey.com

China Tax Services

Ivan Chan
+852 2629 3828
ivan.chan@hk.ey.com

Payroll Operate

Vincent Hu
+852 3752 4885
vincent-wh.hu@hk.ey.com

Accounting Compliance and Reporting

Linda Liu
+86 21 2228 2801
linda-sy.liu@cn.ey.com

Cecilia Feng
+852 2846 9735
cecilia.feng@hk.ey.com

International Tax and Transaction Services

International Tax Services

Winnie Kwan
+852 2629 3211
winnie.yw.kwan@ey.com

Transfer Pricing Services

Sangeeth Aiyappa
+852 2629 3989
sangeeth.aiyappa@hk.ey.com

Martin Richter
+852 2629 3938
martin.richter@hk.ey.com

Kenny Wei
+852 2629 3941
kenny.wei@hk.ey.com

Transaction Tax Services

Jane Hui
+852 2629 3836
jane.hui@hk.ey.com

Jasmine Tian
+852 2629 3738
jasmine.tian@hk.ey.com

Emma Campbell
+852 2629 1714
emma.ef.campbell@hk.ey.com

People Advisory Services

William Cheung
+852 2629 3025
william.cheung@hk.ey.com

Christina Li
+852 2629 3664
christina.li@hk.ey.com

Emily Chan
+852 2629 3250
emily-my.chan@hk.ey.com

Winnie Walker
+852 2629 3693
winnie.walker@hk.ey.com

Paul Wen
+852 2629 3876
paul.wen@hk.ey.com

Financial Services

Paul Ho
Tax Leader for Hong Kong
+852 2849 9564
paul.ho@hk.ey.com

Business Tax Services/Global Compliance and Reporting

Hong Kong Tax Services

Paul Ho
+852 2849 9564
paul.ho@hk.ey.com

Ming Lam
+852 2849 9265
ming.lam@hk.ey.com

Sunny Liu
+852 2846 9883
sunny.liu@hk.ey.com

Helen Mok
+852 2849 9279
helen.mok@hk.ey.com

Customer Tax Operations and Reporting Services

Paul Ho
+852 2849 9564
paul.ho@hk.ey.com

Francis Tang
+852 2629 3618
francis-ks.tang@hk.ey.com

US Tax Services

Camelia Ho
+852 2849 9150
camelia.ho@hk.ey.com

International Tax and Transaction Services

International Tax Services

Sophie Lindsay
+852 3189 4589
sophie.lindsay@hk.ey.com

Maggie Mang
+852 3471 2759
maggie.mang@hk.ey.com

Karen Lui
+852 2232 6455
karen.sy.lui@hk.ey.com

Steve Strathdee
+852 2629 3378
steve.strathdee@hk.ey.com

Transfer Pricing Services

Ka Lok Chu
+852 2629 3044
kalok.chu@hk.ey.com

Justin Kyte
+852 2629 3880
justin.kyte@hk.ey.com

Transaction Tax Services

Sunny Liu
+852 2846 9883
sunny.liu@hk.ey.com

Tax Technology and Transformation Services

Robert Hardesty
+852 2629 3291
robert.hardesty@hk.ey.com

Asia-Pacific Tax Center

Tax Technology and Transformation Services

Albert Lee
+852 2629 3318
albert.lee@hk.ey.com

International Tax and Transaction Services

US Tax Desk

Jeremy Litton
+852 3471 2783
jeremy.litton@hk.ey.com

EY | Building a better working world

EY is building a better working world by creating new value for clients, people, society and the planet, while building trust in capital markets.

Enabled by data, AI and advanced technology, EY teams help clients shape the future with confidence and develop answers for the most pressing issues of today and tomorrow.

EY teams work across a full spectrum of services in assurance, consulting, tax, strategy and transactions. Fueled by sector insights, a globally connected, multidisciplinary network and diverse ecosystem partners, EY teams can provide services in more than 150 countries and territories.

All in to shape the future with confidence.

About EY's Tax services

Your business will only succeed if you build it on a strong foundation and grow it in a sustainable way. At EY, we believe that managing your tax obligations responsibly and proactively can make a critical difference. Our 50,000 talented tax professionals, in more than 150 countries, give you technical knowledge, business experience, consistency and an unwavering commitment to quality service — wherever you are and whatever tax services you need.

APAC no. 03022931
ED None

ey.com/china

Follow us on WeChat
Scan the QR code and stay up to date with the latest EY news.