

Hong Kong Offshore Profits Tax Exemption Assessment

Hong Kong adopts a territorial source principle of taxation. A Hong Kong company is not liable to profits tax on its worldwide profits simply because it is incorporated in Hong Kong. However, the fact that "offshore income of a Hong Kong company is not taxable" does not mean that all overseas income automatically qualifies for exemption.

In the course of providing Hong Kong company tax and compliance services, Kaizen has observed that some businesses still view offshore profits exemption as a matter of whether the contracts, customers and funds are all located overseas, while overlooking the substantive determination of the source of profits and the applicable requirements under the Foreign-sourced Income Exemption (FSIE) regime.

For further details on the application and assessment of offshore profits exemption, please refer to [Guide to Offshore Profit Tax Exemption for Hong Kong Companies](#).

1. Territorial Source Principle: The Legal Basis for the Non-taxation of Offshore Profits

Under section 14 of the Hong Kong Inland Revenue Ordinance (Cap. 112), Hong Kong profits tax is in principle levied only on assessable profits arising in or derived from Hong Kong. Accordingly, non-Hong Kong source profits earned by a Hong Kong company fall, in principle, outside the scope of Hong Kong profits tax, unless other specific charging provisions apply.

It is important to note that the non-taxation of offshore profits does not relieve a company of its accounting, audit and tax reporting obligations.

For a Hong Kong company carrying on substantive business activities, even where all income is derived from overseas, it must still prepare financial statements, undergo audits and fulfil its tax reporting obligations in accordance with the applicable laws and regulations, and provide reasonable explanations and supporting information in respect of its offshore profits claim.

2. Determining Offshore Profits: The Key Is Where the Profit-generating Activities Take Place

The Hong Kong Inland Revenue Department determines, in accordance with Departmental Interpretation and Practice Notes No. 21 (DIPN 21) and relevant judicial precedents, what business activities an enterprise actually carried out to earn the relevant profits and where those activities took place.

SHENZHEN 深圳

Rooms 1203-06, 12/F.
Di Wang Commercial Centre
5002 Shennan Road East
Luohu District, Shenzhen, China
中國深圳市羅湖區深南東路5002號
地王商業中心12樓1203-06室
T: +86 755 8268 4480

SHANGHAI 上海

Room 1201, 12/F., Tower A
Guangqi Culture Plaza
2899A Xietu Road, Xuhui District
Shanghai, China
中國上海市徐匯區斜土路2899甲號
光啟文化廣場A座12樓1201室
T: +86 21 6439 4114

BEIJING 北京

Room 303, 3/F.
Interchina Commercial Building
33 Dengshikou Street
Dongcheng District, Beijing, China
中國北京市東城區燈市口大街33號
國中商業大廈3樓303室
T: +86 10 6210 1890

TAIPEI 台北

Rooms 7F-702, 7/F., 188 Section 5
Nanjing East Road
Songshan District, Taipei
Taiwan 105411
台灣台北市松山區南京東路五段
188號7樓7F-702室
郵編: 105411
T: +886 2 2711 1324

TOKYO 東京

Rooms 502-03, 5/F.,
Lions Mansion Matsugaya
1-4-6 Matsugaya, Taito, Tokyo
Japan 111-0036
日本東京都台東區松谷1-4-6
獅子大廈5樓502-03室
郵編: 111-0036
T: +81 3 5776 2637

SINGAPORE 新加坡

138 Cecil Street, #13-02 Cecil Court
Singapore 069538
T: +65 6438 0116

KUALA LUMPUR 吉隆坡

Menara Suezcap, Tower 2
E-13A-3A, No. 2 Jalan Kerinchi
Gerbang Kerinchi Lestari
59200 Kuala Lumpur, Malaysia
T: +60 19 2177 344

NEW YORK 紐約

202 Canal Street, Suite 303, 3/F.
New York, NY 10013, USA
T: +1 646 850 5888

LONDON 倫敦

Room 5, 2/F., 39-41 High Street
New Malden, Surrey
KT3 4BY, UK
T: +44 20 3910 8392

For trading companies, the process of concluding purchase and sale contracts, transaction negotiations and related business activities are usually important factors in determining the source of profits. For service companies, the place where the services are actually performed is of primary consideration.

For example, where a Hong Kong trading company purchases goods from Mainland China and sells them directly to European customers, the fact that the goods do not pass through Hong Kong and that both the customers and suppliers are located overseas is not, in itself, sufficient to establish that the relevant profits are wholly sourced outside Hong Kong.

The Inland Revenue Department may still further examine where activities such as customer development, acceptance of orders, price negotiations and contract performance actually took place.

Accordingly, whether a Hong Kong company maintains an office or employs staff, or whether goods pass through Hong Kong, is not a set of statutory conditions that must all be satisfied for exemption. The real question is the role those activities played in generating the profits.

Kaizen recommends that businesses properly retain purchase and sales contracts, orders, logistics documents, business correspondence and records of the relevant personnel's performance of their duties in light of their actual business processes, so as to ensure that the offshore profits claim is supported by complete and consistent evidence.

3. FSIE: Separate Assessment of Offshore Income and Economic Substance

Hong Kong has implemented the Foreign-sourced Income Exemption (FSIE) regime since 2023 and further expanded its application to disposal gains in respect of relevant assets in 2024. The regime primarily targets specified foreign-source income received in Hong Kong by members of qualifying multinational enterprise groups, including dividends, interest, intellectual property income and disposal gains in respect of relevant assets. It should be emphasized that the traditional territorial source principle and the FSIE economic substance requirement are two distinct legal tests. The former concerns where profits are generated, while the latter requires enterprises that meet the applicable conditions to satisfy the corresponding exemption requirements in respect of the specified foreign-source income.

For pure equity holding entities, the FSIE regime provides relatively simplified economic substance requirements. For non-pure equity holding entities, it is generally necessary to assess their specified economic activities, qualified personnel and operating expenditure in Hong Kong.

It is worth noting that shareholder loans may affect the qualification of a pure equity holding entity. For example, where a Hong Kong holding company provides a shareholder loan to an overseas subsidiary, even if the loan bears no interest, this may result in the company being unable to apply the simplified economic substance requirements for pure equity holding entities. That said, economic substance is not the only exemption route under the FSIE regime. Certain income may also qualify for participation exemption or other statutory relief arrangements, which must be assessed separately according to the nature of the income.

4. Tax Risks Where an Offshore Claim Is Rejected

The Hong Kong Inland Revenue Department has the power to require enterprises to submit information and provide explanations in respect of offshore profits claims. If a claim is not accepted, the enterprise may be required to pay profits tax on the relevant profits and may face additional assessment. Under section 60 of the Inland Revenue Ordinance, the Inland Revenue Department may generally make an assessment or additional assessment for the past six years of assessment; where fraud or willful evasion is involved, the period may be extended to ten years.

In addition, where an enterprise submits incorrect tax returns, understates profits or otherwise breaches tax requirements, penalties may be triggered. In particular, the additional tax under section 82A may be up to three times the amount of tax undercharged. However, the rejection of an offshore claim does not, in itself, necessarily constitute an offence, and whether a penalty is imposed still depends on the specific facts and statutory conditions.

The Hong Kong territorial source principle of taxation offers cross-border businesses an attractive tax environment, but the non-taxation of offshore profits is not an unconditional benefit. With the implementation of the FSIE regime, tax compliance for Hong Kong companies is no longer confined to the traditional determination of the source of profits; it also requires a comprehensive analysis taking into account the nature of the income, the group structure and economic substance requirements.

Kaizen recommends that businesses, when establishing or adjusting a Hong Kong company structure, consider the source of profits, actual business activities and relevant tax obligations at the same time, so as to apply the Hong Kong tax system lawfully while reducing subsequent tax disputes and cross-border compliance risks.

If you wish to obtain more information or assistance, please visit the official website of Kaizen CPA Limited at www.kaizencpa.com or contact us through the following and talk to our professionals:

Email: info@kaizencpa.com

Tel: +852 2341 1444

Mobile : +852 5616 4140, +86 152 1943 4614

WhatsApp/ Line/ Wechat: +852 5616 4140

Skype: kaizencpa