

Hong Kong Tax Controversy Insight

Common issues under tax audit by the Inland Revenue Department (IRD) - Employer's Obligation

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In Hong Kong, employers are obligated to fulfil specific notification and tax compliance requirements (including record keeping) imposed under the Inland Revenue Ordinance ("IRO") when an employment relationship exists or deemed to exist. Failure to properly discharge the relevant obligations may constitute an offence under the IRO and may attract penalties.

In this insight, EY teams will share observations of the relevant reporting and compliance obligations that employers should be aware of and the potential risks for non-compliance.

Employer's Obligation

Under Section 52 of IRO, an employer is required to furnish Employer's Returns within the stipulated time-frame and to notify the Commissioner of Inland Revenue Department ("IRD") in writing of any changes to the employment status of its employees.

Commencement of employment

When an employer commences to employ in Hong Kong an individual who is or who is likely to be chargeable to salaries tax, Section 52(4) of the IRO requires the employer to file a written notice (Form IR56E) to the Commissioner of the IRD, which should contain the full name and address of the new employee, the date of commencement and the terms of his or her employment. The written notice (Form IR56E) should be filed within three months after the commencement of the employment.

Remuneration paid to employees

Statutory obligations of an employer under the IRO include (i) maintaining record of information pertaining to the employment; and (ii) reporting remuneration paid to employees. In addition, companies may be required to report remuneration paid to persons other than employees. Further details of these obligations are described as follow:

I. Information pertaining to the employment

An employer is obligated to maintain accurate and full records of information listed as follow:

- ▶ Personal particulars of employees including their name, address, marital status, identity card, or passport number with the place of issue;
- ▶ Period and nature of employees' employment;
- ▶ Cash remuneration, non-cash and fringe benefits given to the employees;
- ▶ Employees and employer's contributions to the Mandatory Provident Fund; and
- ▶ Employment contract and amendments to terms of employees' employment.

II. Reporting remuneration paid to employees

An employer should complete and file the respective form(s) for each of the following type of employee(s) to fulfil their obligations under Section 52(2), (4) to (7) of the IRO:

Employment status	Persons	Remarks
Under current employment	Employees of Hong Kong Company	<ul style="list-style-type: none">▶ Regardless of whether they are resident in Hong Kong or not; and▶ Report the total income of employees that is in excess of the basic allowance for the relevant year (i.e. HK\$132,000 from 2018/19 onwards).
	Employees of Non-Hong Kong Company	<ul style="list-style-type: none">▶ Persons being assigned or seconded to a Hong Kong Company for duties in or outside Hong Kong;▶ Report the total income of employees that is in excess of the basic allowance (i.e. HK\$132,000 from 2018/19 onwards).
	Part-time employees	<ul style="list-style-type: none">▶ Report the remuneration of employees if their total income is likely to be chargeable to Salaries Tax.
	Directors	<ul style="list-style-type: none">▶ Report the remuneration for directors if they are likely to be chargeable to Salaries Tax.
Under former employment	Employees and directors	<ul style="list-style-type: none">▶ Report the gain on share option previously granted, in the year the gain is realized (i.e. by exercise, assignment or release); and▶ Report the vested share awards after cessation of employment by "replacement" of or written notification of amendment to the IR56 forms previously filed.

III. Reporting remuneration paid to persons other than employees

When a company pays commission, fees or other remunerations to local persons who are not employees of the company, it may be required to file a Form IR56M if the amount paid exceeds the threshold listed as follows:

Persons	Threshold of payment
Sub-contractors	Exceeding \$200,000 per annum
Consultants, Agents, Brokers, Freelance artistes Entertainers, Sportsmen, Writers, Freelance guides	Exceeding \$25,000 per annum

Potential risk of omission

Pursuant to Section 9 of the IRO, general emoluments specified under Section 9(1)(a) includes “wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance”, which are chargeable to salaries tax.

Employers should report the particulars of income such as salary/wages, commission/fees, gain realized under share option scheme and any other rewards allowances or perquisites, etc. in the respective Employer’s Returns for their employees.

Employers should also be mindful of the reporting requirements for rewards allowances and perquisites that are usually regarded as “fringe benefits”. Due care should be exercised to ascertain whether such fringe benefits are taxable under Section 9 of the IRO.

Taxability of fringe benefits is often controversial and could easily be overlooked when preparing the Employer’s Return.

Below are some examples of the general treatment of fringe benefits:

Nature of fringe benefits	Not chargeable to Salaries Tax	Chargeable to Salaries Tax
Medical scheme	Medical insurance premium paid by employer in respect of medical benefits provided to its employees i.e. where the employer has the sole liability towards the medical insurance premium	Reimbursement of medical insurance premium in respect of a private medical plan taken out in the employee’s name
Meal allowance	Meals provided to employee	Meal allowances given to employees

Actions to be taken on omission or underreport

If an employer discovers an omission/underreporting of the employees’ remuneration, the employer should take rectification measures as early as possible to mitigate the associated non-compliance risk. These measures include:

I. Submission of additional/replacement/supplementary IR56 Forms

In case there is any under/overreporting of the employees’ remuneration, the employer could arrange to amend the incorrect Employer’s Returns through submission of additional/ replacement/ supplementary IR56 Forms to the IRD.

II. Voluntary disclosure

Employers are encouraged to make full voluntary disclosure of any omission/underreporting and submit proposals for the IRD’s consideration as early as possible. Once the employer discovers that their reporting is not in order, a full voluntary disclosure to the IRD is recommended which could usually mitigate the amount of penalty to be imposed.

Failure to fulfill the obligation

If an employer fails to comply with the requirements of Section 52(2), they may be liable to a fine at level 3 (i.e. HK\$10,000) and the Court may order the employer to perform the act which they fail to do within a time specified.

Recommendations

Employers are recommended to clearly understand the obligations set forth under the IRO. They are encouraged to keep complete employment related records of their employees and to report the remunerations paid to them in a timely and accurate manner.

Moreover, employers are encouraged to closely monitor the nature of the employees' benefits package to avoid the risk of potential omission/underreporting.

Failure to fulfil the obligations may result in queries from the IRD, which may lead to potential tax audit and/or penalties.



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