



Film Financing and Television Programming

A Taxation Guide

For more than a decade, the KPMG Film Financing and Television Programming Taxation Guide has been recognized as a valued reference tool for industry professionals, filled with information drawn from the knowledge of the KPMG International global network of member firm media and entertainment Tax professionals. The 2022 edition is a fundamental resource for film and television producers, studio and streaming production executives, tax executives, finance executives, and attorneys involved with the commercial side of production.

Doing business across borders can pose major challenges and may lead to potentially significant tax implications, and a detailed understanding of the full range of potential tax implications can be as essential as the actual financing of a project. The Guide helps industry executives assess the many issues surrounding cross-border business conditions, financing structures, and issues associated with them, including development costs and rules around foreign investment. Recognizing the role that tax credits, subsidies, and other government incentives play in production financing, the Guide includes a robust discussion of relevant tax incentive programs in each country.

Each chapter focuses on a single country and provides a description of commonly used financing structures, as well as their potential commercial and tax implications for the parties involved. Key sections in each chapter include:

Introduction

A thumbnail description of the country's industry contacts, regulatory bodies, and financing developments and trends.

Key Tax Facts

At-a-glance tables of corporate, personal, and value-added (VAT) tax rates; normal nontreaty withholding tax rates; and tax year-end information for companies and individuals.

Financing Structures

Descriptions of commonly used financing structures in production and distribution, and the potential commercial tax implications for the parties involved. This section of each chapter covers rules surrounding co-productions, partnerships, equity tracking shares, sales and leaseback, subsidiaries, and other tax-efficient structures.

Tax and Financial Incentives

Details regarding the tax and financial incentives available from central and local governments as they apply to investors, producers, distributors, and actors, as well as other types of incentives offered.

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Corporate Tax

Explanations of the corporate tax in the country, including definitions, rates, and how they are applied.

Personal Tax

Personal tax rules from the perspective of investors, producers, distributors, artists, and employees.

Streaming Tax Considerations

Provides a look at the unique tax issues that need to be addressed in this evolving segment of the industry. With considerations such as identifying tax collection and reporting obligations in a variety of jurisdictions, understanding international tax implications is essential for streaming providers.

KPMG and Member Firm Contacts

References to KPMG and other KPMG International member firms' contacts at the end of each chapter are provided as a resource for additional detailed information.

Please note: While every effort has been made to provide up-to-date information, tax laws around the world are constantly changing. Accordingly, the material contained in this publication should be viewed as a general guide only and should not be relied upon without consulting your KPMG or KPMG International member firm Tax advisor.

Production opportunities are not limited to the countries contained in this Guide. KPMG and the other KPMG International member firms are in the business of identifying early-stage emerging trends to assist clients in navigating new business opportunities. We encourage you to consult a KPMG or KPMG International member firm Tax professional to continue the conversation about potential approaches to critical tax and business issues facing the media and entertainment industry.

We look forward to helping you with your film and television production ambitions.

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The following information is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

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Introduction

In recent years, the Hong Kong SAR Government has been allocating more resources to drive the development of the cultural and creative industries and promote Hong Kong SAR as an intellectual property (IP) trading center in the ASPAC region. As the industry has increasingly made use of technology in production through various means, the government has also been promoting the integration of arts and innovation and technology as a new trend of development.

One of the film industry's most valuable assets is IPs that usually take the form of a copyright, trademark, or know-how rights. Hong Kong has a strong IP protection regime, efficient IP commercialization, and highly skilled IP professionals who can provide various intermediary support services to Hong Kong's technology and IP related sectors. In the 2021 World Competitiveness Yearbook, published by the International Institute for Management Development in Switzerland, Hong Kong is ranked seventh globally on the criterion of IP rights.

Hong Kong currently has a relatively simple and low tax regime. There are no specific provisions contained in the Inland Revenue Ordinance (IRO) that deal with the taxation of profits derived from the film industry. As such, the general taxing provisions apply. A brief discussion of these provisions is provided below, focusing on the provisions relevant to the film industry.

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Key Tax Facts

Corporate income tax rates	16.5% (15% for unincorporated bodies)*
Personal income tax rates	2% to 17%/15%**
Normal nontreaty withholding tax rates:	
Dividends	0%
Interest	0%
Royalties	See Withholding Tax section
Tax year-end: Companies	Accounting year-end; most companies in Hong Kong adopt a calendar year (i.e., January 1 to December 31) as their fiscal year. However, this can be varied, if required.
Tax year-end: Individuals	March 31

* Effective from the 2018–2019 year of assessment (i.e., commencing on or after April 1, 2018), a two-tiered profits tax regime applies for both corporations and unincorporated businesses. The reduced profits tax rates of 8.25% and 7.5% apply to the first HKD 2 million of assessable profits for a corporation and for an unincorporated business, respectively. Assessable profits exceeding HKD 2 million will continue to be taxed at the standard rates of 16.5% for corporations and 15% for unincorporated businesses. For corporate groups, only one member of the group will be able to apply the reduced rate.

** Hong Kong Salaries Tax is calculated at the lower of:

- Income after applicable deductions but without personal allowances at the standard rate of 15%; and
- Income after applicable deductions and personal allowances charged at progressive rates ranging from 2% to 17%.

Film Financing

Financing Structures

Various mechanisms for film financing are feasible. These include the provision of funds by way of share capital or loan finance (or a mixture of both) to a company, the creation of joint ventures involving companies and/or individuals, and the establishment of partnerships involving companies and/or individuals. The choice of structure in any particular case normally depends on the particular facts and circumstances of that case, and it is usually possible to create a structure that meets both the commercial and tax objectives of the parties.

Co-production

Two or more parties may enter into a joint venture agreement to co-produce a film or, alternatively, to produce and/or finance a film whereby, typically, the rights to exploit the film are divided among the parties. The existence of a joint venture agreement does not necessarily mean that a partnership or profit-sharing arrangement exists. The joint venture itself is not normally taxable if there is not a separate entity (such as a corporation) being formed as the joint venture entity. Rather, each party to the joint venture must consider its role in the venture to assess its particular tax position.

Partnership

Two or more parties may come together to produce and exploit a film in partnership. Partnerships in Hong Kong can have both limited and general partners. A partnership is a taxable entity in Hong Kong (i.e., not

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a tax-transparent entity) and its profits are subject to tax in the name of the partnership. Each partner of the partnership is jointly and severally liable for the profits tax liability of the partnership. Restrictions are, however, placed upon the use of losses in partnerships. Neither general nor limited partners can offset losses derived from their participation in one partnership against profits derived from their participation in another partnership. However, partnership losses can be offset against other income derived by the partners in their own right. In addition, a limited partner's share of a loss in a partnership is generally limited to the limited partner's capital contribution.

Limited Liability Company in Hong Kong/Branch of a Foreign Company

A limited liability company or a branch of a foreign company could be established in Hong Kong to produce and exploit a film. If a branch of a foreign company establishes a "place of business" in Hong Kong, the branch must register with the Registrar of Companies under Part 16 of the Hong Kong Companies Ordinance and perform a business registration in Hong Kong.

Equity Tracking Shares

Equity tracking shares (typically known as preferred or preference shares) provide for dividend returns, which are dependent on the profitability of a film production company's business. The investor acquires such shares in the production company. These shares have the same rights as the production company's ordinary shares except that the dividends are profit-linked and have preferential rights to the assets in the event of the liquidation of the company.

Regardless of the place of incorporation of the production company, dividends received on equity tracking shares are exempt from Hong Kong profits tax in the same way as dividends earned on ordinary shares, provided that the profits of the production company are chargeable to profits tax or the dividends are regarded as non-Hong-Kong sourced.

Yield Adjusted Debt

A film production company may issue a "debt security" to investors. Its yield may be linked to the revenue from specific films. The principal would be repaid upon maturity and there may be a low (or even nil) rate of interest stated on the debt instrument. However, at each interest payment date, a supplemental (and perhaps, increasing) interest payment may be paid where a predetermined target is reached or exceeded (such as revenue or net cash proceeds).

For Hong Kong profits tax purposes, this "debt security" would be classified as debt. The accessibility and deductibility of the interest payments on the debt security would be determined based upon the rules for accessibility and deductibility as outlined below.

Other Financing Considerations

Exchange Controls and Regulatory Rules

Hong Kong does not have any exchange controls or regulatory rules restricting currency movements. There is, therefore, nothing to prevent a foreign investor or artist from repatriating income arising in Hong Kong back to his or her home territory.

Corporate Taxation

Hong Kong Profits Tax

Assessable Profits

Hong Kong operates a "territorial" system of taxation. This means a "person" will only be chargeable to profits tax in respect of his or her "assessable profits" if:

- The profit arises from a trade, profession, or business carried on by the person in Hong Kong; and
- The profit arises in or is derived from Hong Kong.

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“Person” is defined to include a corporation, partnership, trustee (whether incorporated or unincorporated), or body of persons.

Income that is capital in nature (e.g., sale of an IP that is a capital asset) is not chargeable to profits tax.

Certain income that would not otherwise be subject to tax in Hong Kong under the general charging provision will be deemed as taxable trading receipts arising from or derived in Hong Kong under certain deeming provisions. These include certain royalties derived by a nonresident person (see Withholding Tax section).

Generally, there is no distinction between resident and nonresident companies in terms of the liability to Hong Kong profits tax except in a tax treaty context.

Carrying on Business in Hong Kong

Whether a company is carrying on business in Hong Kong is a question of fact. Based on precedent cases, very minimal activities can constitute the carrying on of a trade or business. In practice, a company is considered to be carrying on business in Hong Kong if it has an office, a place of business, or if part of its business activities are undertaken in Hong Kong. If a company is regarded as carrying on business in Hong Kong, then the profits from that business will be subject to profits tax unless they are considered to be “offshore-sourced” (i.e., non-Hong-Kong sourced) or specifically exempt from tax (e.g., dividends and capital gains).

Source of Profits

The question of locality of profits is a practical matter of fact that is ultimately decided on the basis of substance rather than form. In assessing the source of a particular type of profit, all relevant factors must be considered and weighed together to decide where in substance the activities that generate the relevant profit are undertaken. There are many cases that have been heard by the Board of Review and the Hong Kong Courts regarding locality of profits. However, ultimately, the determination of where a particular item of income derived is sourced is dependent on the specific fact pattern in each case.

In the case of *CIR vs. HK – TVB International Limited* (1992) (1 HKRC 90-064), which related to the source of profits arising from the sublicensing of rights to films, a Hong-Kong-based company acquired non-Hong-Kong rights to films from its parent company that produced the films. The rights were then sublicensed to unrelated television stations and film distributors outside Hong Kong. Although the sublicensees were located outside Hong Kong, the substance of the work performed to earn the profits was undertaken in Hong Kong, and it was held that the profits were Hong-Kong-sourced and taxable.

The Inland Revenue Department’s (IRD) general principles for determining the source of profits and specific sourcing rules for various types of profits (e.g., trading profits, service fees, and commission income) are set out in the nonbinding statement of practice, revised Departmental Interpretation and Practice Notes No.21 (DIPN 21) on “Locality of Profits.”

More detailed and specific guidelines on determining the source of royalty income are included in revised Departmental Interpretation and Practice Notes (DIPN) No. 22 on ‘Taxation of Royalties and Other Income from Intellectual Properties’. The revised DIPN 22 states that the source of royalty income will be determined using the totality of facts approach. In particular, revised DIPN 22 set out the general principles for determining the source of royalties in the following three scenarios:

1. Licensing of IP created or developed by licensor – The source is determined by the place where the IP is created or developed; the place where the licensee uses the IP is not relevant. If an IP is created or developed in Hong Kong, then the royalty income derived from the IP would generally be regarded as Hong Kong sourced and subject to Hong Kong profits tax regardless of the location of usage.

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2. Licensing of IPs purchased by licensor – The source is determined by the place of purchase and licensing of the IP. If an IP was purchased and licensed for use outside Hong Kong, then the royalty income derived would generally be regarded as non-Hong-Kong sourced and not taxable in Hong Kong.
3. Sublicensing of IPs which is not owned by licensor – The source is determined by the place of acquiring and granting the license. If the license for the use of the IP is acquired in Hong Kong and the sublicense is granted in Hong Kong, then the royalty derived from such sublicensing would be regarded as Hong Kong sourced.

Deeming Provision for Royalty Derived by Nonresident Associates

There is a specific provision in the IRO where a person who has contributed to the development, enhancement, maintenance, protection, or exploitation (DEMPE) of an IP in Hong Kong will be regarded as the economic owner of such IP and therefore will be subject to Hong Kong profits tax for a portion of the royalty income derived by its non-Hong-Kong resident associate from the IP. The portion of the royalty that would be deemed as taxable in Hong Kong will be the part that is attributable to the value creation contributions of the person in Hong Kong.

Treatment of Dividends

Dividends received from a corporation whose profits are chargeable to profits tax are exempt from tax. Dividends from overseas companies are generally considered to be offshore sourced and not subject to tax in Hong Kong. Hong Kong does not have an imputation system.

Deduction of Expenses

Generally, expenses are deductible to the extent that they are incurred in the production of the taxpayer's assessable profits for any period and they are not capital in nature. IP amortisation expenses are generally capital in nature and therefore not deductible.

Any sums paid for registering trademarks, designs, or patents used in the production of assessable profits are deductible.

Capital expenditures incurred on the purchase of patents, industrial know-how, registered trademarks, copyrights, registered designs, and performer's rights could qualify for a tax deduction over a period ranging from one to five years, subject to certain specified conditions and anti-avoidance provisions. Additional guidance on deduction of the capital expenditures incurred on acquisition of IPs is set out in revised DIPN 49.

The following is a list of other allowable deductions that are generally relevant to the film industry:

- Certain interest and related costs on money borrowed for the purpose of producing assessable profits (see further below);
- Rent paid for premises occupied for the purpose of producing assessable profits;
- Bad and doubtful debts, provided the debts were included in the taxpayer's assessable profits and that they can be proven to have become bad or credit-impaired; and debts in respect of money lent in the ordinary course of the business of money-lending within Hong Kong by a person who carries on a money-lending business;
- Tax depreciation allowances for plant and machinery, industrial buildings or commercial buildings;
- Expenditure on plant and machinery used for specified manufacturing activities and computer hardware and software that is fully deductible in the year the expenditure was incurred;
- Expenditure on the renovation or refurbishment of a commercial building allowed as a deduction on a straight-line basis over a five-year period;

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- Cost of repairing premises, plant, machinery, implements, utensils or articles used in the production of the taxpayer's assessable profits and the cost of the replacement of any implements, utensils, or articles, provided that no claims were previously made for depreciation allowances;
- Expenditure on environmentally friendly machinery and equipment is fully deductible in the year the expenditure is incurred;
- Expenditure on environmentally friendly installations ancillary to buildings is allowed as a deduction on a straight-line basis over a five-year period.
- There are no specific provisions in the IRO that deal with the deductibility of costs incurred to produce or acquire a film. In addition, the IRD has not published any guidelines stating how they would treat such expenditures for Hong Kong profit tax purposes. Therefore, there is a technical risk that the IRD may consider such expenditures to be capital in nature and nondeductible.

Deductions for Interest and Related Borrowing Costs

A deduction for interest will be allowed where the interest is incurred on money borrowed for the purpose of producing the taxpayer's assessable profits and at least one of the specified conditions in the IRO is met. In particular, the condition that would be more relevant to the film industry is that the interest was paid on money borrowed:

1. From a person (other than a financial institution) who is subject to Hong Kong profits tax on that interest;
2. From a financial institution either in Hong Kong or overseas;
3. Wholly and exclusively to finance:
 - i) A capital expenditure incurred on the provision of machinery or plant that qualifies for depreciation allowances for profits tax purposes, or
 - ii) The purchase of trading stock that is used in the production of profits chargeable to profits tax, provided the lender is not associated or connected with the borrower; or
4. Through the issue of certain publicly quoted debentures and certain commercial papers.

In relation to conditions (1), (2), and (3) mentioned above, specific anti-avoidance provisions have been introduced with effect from June 25, 2004, which preclude a deduction from being claimed for interest on a loan that is secured by either a deposit or a loan made by the taxpayer (or an associate), and the interest on the loan or deposit is not subject to Hong Kong profits tax. Where the loan is partly secured by "tax-free deposits or loans," the interest deduction will be apportioned on a "most reasonable and appropriate" basis, depending on the circumstances of the case.

In addition, the deduction for interest under all conditions mentioned above is also subject to what is commonly referred to as an "interest flow-back test." Under this test, interest is not deductible where there is an arrangement in place between the borrower and lender whereby the interest is ultimately paid back to the borrower or a person connected with the borrower. A connected person is defined as an associated corporation or a person who controls the borrower, or who is controlled by the borrower, or who is under the control of the same person as the borrower.

A partial deduction for interest is permitted where the interest only partially flows back to the borrower, but only in proportion to the number of days during the year in which the arrangement is in place. The test does not apply where the interest is payable to an "excepted person," which is defined to include a person who is subject to tax in Hong Kong on the interest, a financial institution or an overseas financial institution, a retirement fund or collective investment fund in which the borrower or an associate has an interest, and a government-owned corporation.

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Withholding Tax

Hong Kong does not currently impose any withholding tax (WHT) on dividends, interest, technical service fees, or management fees, whether paid to residents or nonresidents.

However, Hong Kong profits tax is imposed under the deeming provisions on amounts received by or accrued to nonresident persons who are not otherwise subject to Hong Kong profits tax under the general charging provision:

1. From the exhibition or use in Hong Kong of any cinematography or television film, any tape or sound recording, or any advertising material connected with any of these things;
2. For the use of or the right to use certain intellectual properties in Hong Kong, including patents, designs, trademarks, copyright materials, performer's rights or secret processes or formula;
3. For the imparting or undertaking to impart knowledge directly or indirectly connected with the use of any of the intellectual properties mentioned in (2) above in Hong Kong; or
4. For an assignment of, or an agreement to assign, a performer's right in relation to a performance given by the performer in Hong Kong, where the amount is received by a performer or an organizer.

A deemed profit of 30% of the royalty is generally used to compute the amount of the WHT payable. Given the two-tiered profits tax rates of 8.25% and 16.5% for corporations, the effective tax rates can be 2.475% for the first HKD 6.67 million of gross royalty income and 4.95% for the remaining amount of gross royalty income. However, the effective tax rate of 2.475% only applies to one nominated group entity of the nonresident recipient group upon election.

In cases where a person carrying on a trade or business in the Hong Kong SAR has, at any time, wholly or partly owned the IP in respect of which the royalties are paid and the nonresident person is an associate of the Hong Kong payer, the deemed profits will be 100% of the royalty amount.

If a Hong Kong tax treaty is applicable, then a reduced WHT rate under the treaty may apply.

Even if the intellectual properties mentioned in (1) and (2) above are wholly used outside of Hong Kong, the royalty payments are deemed to be subject to Hong Kong profits tax where a deduction can be claimed by the payer in respect of the royalty payment for Hong Kong profits tax purposes.

Personal Taxation

Artists

Sums received or profits derived directly or indirectly from performance(s) in Hong Kong by an entertainer, irrespective of whether or not she or he is a Hong Kong resident, are generally subject to Hong Kong profits tax.

The IRO also provides that a nonresident entertainer is subject to Hong Kong profits tax in the name of the person in Hong Kong who pays or credits sums to that entertainer or his or her agent. The Hong Kong person who made the payment is responsible for (i) withholding an appropriate amount to pay the nonresident entertainer's tax liability, (ii) completing the tax return to report the gross amount payable to the recipient, and (iii) settling the tax due with the IRD. For the above purposes, an entertainer is defined as a person who gives performances (whether alone or with other persons) in his or her character as an entertainer in any kind of entertainment, including an activity in a live or recorded form that the public is or may be permitted to see or hear, whether for payment or not.

Where a Hong Kong tax treaty is applicable, the provisions under the Entertainers and Sportspersons Article in the treaty should be taken into consideration when ascertaining the profits tax liability in Hong Kong.

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Employees

A separate tax, called salaries tax, is charged on an individual in respect of his or her income arising in or derived from Hong Kong from any office or employment sourced in Hong Kong; and in the case of employment sourced outside Hong Kong, on any income derived from services rendered in Hong Kong. However, individuals who visit Hong Kong to render services for not more than 60 days in a year of assessment are exempt from salaries tax.

Where a Hong Kong tax treaty is applicable, the provisions under the Income from Employment Article in the treaty should be taken into consideration in ascertaining the salaries tax liability in Hong Kong.

Double Tax Treaty Network

Hong Kong has significantly expanded its tax treaty network with key trading partners worldwide in recent years. As of February 2022, Hong Kong has entered a comprehensive double taxation agreement (“CDTA”) with 45 territories, the most recent being with Georgia. Hong Kong is also in the process of negotiating treaties with more than 14 jurisdictions.

The Hong Kong government is continuing its efforts to maintain Hong Kong as an attractive location for foreign investors and is aiming to increase its double tax treaty network to over 50 treaties in the coming years. Residents of jurisdictions that have double tax treaties with Hong Kong should therefore check the relevant tax treaty agreement to assess the tax implications, if any, for their tax affairs.

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