

# Hong Kong has just signed 3 Comprehensive Double Taxation Agreements

Hong Kong

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As mentioned in our newsletter published in January 2010, Hong Kong introduced the Inland Revenue (Amendment) Ordinance 2010 in January in order to enable Hong Kong to adopt the latest international standard for exchange of information, i.e. the Organisation for Economic Co-operation and Development (“OECD”) 2004 Model Tax Convention Exchange of Information (“EoI”) Article. The Amendment Ordinance and the Inland Revenue (Disclosure of Information) Rules have commenced to operate on 12 March 2010. With the commencement of the new legislation, Hong Kong can enter into Comprehensive double taxation agreements (“CDTAs”) based on OECD 2004 version of EoI Article. As anticipated, this has accelerated Hong Kong’s treaty negotiations with other countries and Hong Kong has just signed three CDTAs with Brunei, the Netherlands and Indonesia on 20, 22 and 23 March 2010 respectively.

The objectives of CDTAs are mainly to avoid double taxation, grant reduction in withholding taxes on a reciprocal basis and provide tax certainties in connection with cross-border economic activities. In addition, they will also allow tax authorities of two contracting parties to exchange information on taxpayers to prevent avoidance or evasion of taxes.

## **Common Features**

The common features of the three CDTAs signed by Hong Kong with Brunei, the Netherlands and Indonesia (“Contracting States”) are set forth as follows from the perspectives of Hong Kong tax residents:

### Business Profit

Under the business profits article, the profits of a Hong Kong enterprise will only be taxable in the Contracting States if they were derived from a permanent establishment maintained by the Hong Kong enterprise in the Contracting States.

### Associated Enterprises (Transfer Pricing)

The three CDTAs contained an associated enterprise article which allows Hong Kong or the contracting parties to make transfer pricing adjustments for transactions between associated enterprises. Such adjustments may give rise to potential double taxation. The article also provides that the tax authorities on the other side shall make an appropriate adjustment in order to relieve the double taxation.

## Capital Gains

In general, under the three CDTAs, gains on disposal of capital assets by a Hong Kong enterprise should only be taxed in Hong Kong unless the following situations:

1. The properties are immovable properties situated in the Contracting States;
2. The properties are movable properties of a permanent establishment maintained by the Hong Kong enterprise in the Contracting States; and
3. The properties are shares in a company of the Contracting States, the assets of which are comprised of not less than 50% of immovable properties situated in the treaty countries, subject to certain exceptions.

## Income from Employment

Hong Kong individual is exempted from tax in the Contracting States if he satisfies the following conditions:

1. He is present in the Contracting States for not more than 183 days in any 12-month period commencing or ending in tax year;
2. His remuneration is borne by an employer who is not a resident of the Contracting States; and
3. His remuneration is not borne by a permanent establishment maintained by his employer in the Contracting States.

## **Reduction on Withholding Tax**

The three CDTAs offer favourable withholding tax rates in the Contracting States. The following is a summary of the withholding rates for dividends, royalties and interest under the three CDTAs:

	<u>Dividend</u>	<u>Royalties</u>	<u>Interest</u>
<b><i>HK non treaty rate</i></b>	0%	4.5% (1)/4.95% (2)	0%
<b><i>HK-Brunei DTA</i></b>			
Brunei non-treaty rate	0%	10%	15%
Treaty rate	0%	5%	5% (3) / 10%
<b><i>HK-Netherlands DTA</i></b>			
Netherlands non-treaty rate	15%	0%	0%
Treaty rate	0% (4) /10%	3% (5)	0%
<b><i>HK-Indonesia DTA</i></b>			
Indonesia non-treaty rate	20%	20%	20%
Treaty rate	5% (6) / 10%	5%	10%

(1) Received by an unincorporated business.

(2) Received by a corporation.

(3) Received by a bank or financial institution.

(4) Received by a qualifying person holding at least 10% of the share capital of the paying company or received by a bank, insurance company, pension fund, headquarters company etc.

(5) Hong Kong agreed to reduce the withholding tax rate to 3%.

(6) Received by a company holding at least 25% of the share capital of the paying company.

The three CDTAs will come into force after the completion of ratification procedures on in Hong Kong and the Contracting States.

## **Conclusion**

Hong Kong is actively seeking to establish a network of CDTAs, and concluded CDTAs with Belgium in 2003, Thailand in 2005, the Mainland of China in 2006, Luxembourg in 2007 and Vietnam in 2008. The signing of the agreement marks a new page for Hong Kong in supporting the international effort in enhancing tax transparency.

Including the three new CDTAs, Hong Kong now has 8 CDTAs. The three CDTAs are the first batch of CDTAs signed by Hong Kong using the latest OECD standard on exchange of information. Hong Kong has already concluded CDTAs with Austria, France, Hungary, Ireland and Liechtenstein. The second batch of CTDs will soon be signed by Hong Kong and the treaty partners. With the amendment to its tax law on EoI, Hong Kong has accelerated its treaty negotiations with other countries and should be able to build up its own network of CDTAs soon.

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