Chapter 14

INTERNATIONAL TAX CONSIDERATIONS

¶14-0500 Overview

A taxpayer may be subject to tax both in Hong Kong and overseas. The Ordinance provides that arrangements may be made with other territories to afford relief from double taxation when the other territory imposes a tax similar in character to a Hong Kong tax (sec 49(1)).

Hong Kong entered into its first comprehensive double tax agreement with Belgium on 10 December 2003. In line with the Financial Secretary's statement in his 2004/05 Budget Speech that the Government would continue its discussions with countries outside the region and start negotiations with some of Hong Kong's major regional partners, Hong Kong subsequently entered into a comprehensive agreement with Thailand on the avoidance of double taxation on 7 September 2005. This was the first comprehensive agreement on the avoidance of double taxation that Hong Kong had signed with an Asia–Pacific country, and the second since the agreement signed with Belgium (see ¶8-5000).

To prevent double taxation of income between Hong Kong and Mainland China, the two parties concluded a comprehensive arrangement on 21 August 2006 (see ¶8-6500 for details).

Hong Kong then concluded its fourth comprehensive agreement on the avoidance of double taxation with Luxembourg on 2 November 2007 and the fifth with Vietnam on 16 December 2008. During 2010, Hong Kong signed 13 further comprehensive double tax agreements, with Brunei, The Netherlands, Indonesia, Kuwait, Hungary, Austria, United Kingdom, Ireland, Liechtenstein, France, Japan, New Zealand and Switzerland (the comprehensive double tax agreement with Switzerland was abrogated and re-signed in 2011). During 2011, four more comprehensive agreements were signed with Portugal, Spain, Czech Republic and Malta. Four more comprehensive double tax agreements were signed with Jersey, Malaysia, Mexico and Canada in 2012. In 2013, three comprehensive double tax agreements were also signed with Italy, Qatar and Guernsey. Additionally, between 2014 and July 2016, six comprehensive double tax agreements were signed with Korea, South Africa, the United Arab Emirates, Romania, Russia, Latvia as well as a protocol with Vietnam.

As another measure, specifically to protect international aircraft and shipping operators from double tax charges, Hong Kong has concluded:

- shipping income agreements with various countries which include provisions to prevent the double taxation of international shipping income (see ¶8-2000); and

- air services agreements with various countries which include provisions to prevent the double taxation of income arising from international air traffic operations (see ¶14-3500).

Under British rule, taxation relief was available when a taxpayer who was liable for Hong Kong tax was also liable for income tax in another Commonwealth country. With the handover of sovereignty to China, Commonwealth tax relief is no longer available. The removal of the relief took effect from the 1998/99 year of assessment (see ¶14-8000).

COMPREHENSIVE DOUBLE TAXATION AGREEMENTS

¶14-1000 Comprehensive double taxation agreements

The comprehensive agreement for the avoidance of double taxation signed between the Hong Kong Special Administrative Region Government and Belgium on 10 December 2003 represented an important milestone for Hong Kong. This agreement was the first comprehensive agreement for the avoidance of double taxation concluded by the government with another economy. In line with the government's objective to continue its discussions with countries outside the region and to start negotiations with some of Hong Kong's major regional partners, Hong Kong has signed a series of comprehensive double taxation agreements ("CDTAs") with other countries, as of 24 August 2017, Hong Kong has signed 38 comprehensive agreements with its business and trading partners.

Please refer to the table below for further details.

Country	CDTA signed by Hong Kong	Signatory date	Effective year of assessment/ Date	Tax on dividends	Tax on interest	Tax on royalties
Austria	11th	25/5/2010	Year of assessment 2012/13	• 0% If The Beneficial Owner Is A Company Which Holds Directly At Least 10% Of The Capital Of The Company Paying The Dividends • 10% In All Other Cases	• 0%	• 3%
(Protocol)		25/6/2012	Year of assessment 2013/14			
Belarus	36th	16/1/2017	Pending notification	• 5%	• 5%	• 3% for the use of, or right to use aircraft • 5% in all other cases
Belgium	1st	10/12/2003	Year of assessment 2004/05	• 0% if the beneficial owner is a company which, at the time of the payment of dividends, holds at least 25% of the capital of the company paying	• 0% for interest payments to a government institution or a financial institution	• 5%

				the dividends for an uninterrupted period of at least 12 months • 5% if the beneficial owner is a company which holds directly at least 10% of the capital of the company paying the dividends • 15% in all other cases	• 10% in all other cases	
Brunei	6th	20/3/2010	Year of assessment 2011/12	• 0%	• 0% for interest payments to government institutions • 5% for interest payments to banks or financial institutions • 10% in all other cases	• 5%
Canada	26th	11/11/2012	Year of assessment 2014/15	• 5% if the beneficial owner is a company which holds directly or indirectly at least 10% of the share capital of the paying company	• 0% for Government, other authorities of Government and other local authorities agreed	• 10%

				• 15% in all other cases	between the competent authorities of Hong Kong and Canada; or if the beneficial owner is a resident of the other contracting party and is dealing at arm's length with the payer • 10% in all other cases	
China	3rd	21/8/2006	Year of assessment 2007/08	• 5% if the beneficial owner is a company which holds directly at least 25% of the capital of the company paying the dividends for a consecutive 12-month period before receipt of the dividends	• 0% for HKSAR Government or other recognised institutions	• 7%
(3rd Protocol)		27/5/2010	Year of assessment 2010/11		• 7% in all other cases	

(4th Protocol)		01/04/2015	29/12/2015	• 10% in all other cases		• 5% for aircraft leasing and ship chartering
Czech Republic	21st	6/6/2011	Year of assessment 2013/14	• 5%	• 0%	• 10%
France	15th	21/10/2010	Year of assessment 2012/13	• 10%	• 0% for government and other recognised financial establishments • 10% in all other cases	• 10%
Guernsey	28th	22/4/2013	Year of assessment 2014/15	• 0%	• 0%	• 4%
Hungary	9th	12/5/2010	Year of assessment 2012/13	• 5% if the beneficial owner is a company which holds directly at least 10% of the capital of the company paying the dividends • 10% in all other cases	• 0% if the interest is received by a government institution • 5% in all other cases	• 5%

Indonesia	8th	23/3/2010	Year of assessment 2013/14	• 5% if the beneficial owner is a company holding at least 25% of the share capital of the paying company • 10% in all other cases	• 0% for government and other recognised financial establishments • 10% in all other cases	• 5%
Ireland	13th	22/6/2010	Year of assessment 2012/13	• 0%	• 10%	• 3%
Italy	27th	14/1/2013	Year of assessment 2016/17	• 10%	• 0% for government bodies • 12.5% for other cases	• 15%
Japan	16th	9/11/2010	Year of assessment 2012/13	• 5% for companies holding (directly or indirectly) at least 10% of the voting shares of the company paying the dividends for a period of six months • 10% for other cases	• 0% for government and other recognised financial establishments • 10% in all other cases	• 5%

Jersey	23rd	22/2/2012	Year of assessment 2014/15	• 0%	• 0%	• 4%
Korea	31st	08/07/2014	Year of assessment 2017/18	• 10% if the beneficial owner is a company (other than a partnership), which holds directly at least 25% of the capital of the company paying the dividends • 15% in all other cases	• 0% for government and other recognised financial establishments • 10% in all other cases	• 10%
Kuwait	10th	13/5/2010	Year of assessment 2014/15	• 0% for Government, its institutions or other entity wholly-owned directly by the Government • 5% in all other cases	• 0% for government and other recognised financial establishments • 5% in all other cases	• 5%
Latvia	35th	13/04/2016	Pending notification	• 0% for companies • 10% in all other cases	• 0% for companies • 10% in all other cases	• 0% for companies • 3% in all other cases

Liechtenstein	14th	12/8/2010	Year of assessment 2012/13	• 0%	• 0%	• 3%
Luxembourg	4th	2/11/2007	Year of assessment 2008/09	• 0% if the beneficial owner is a company which holds directly at least 10% of the capital of the company paying the dividends or a participation with an acquisition cost of at least EUR 1.2 million in the company paying the dividends	• 0%	• 3%
(Protocol)		11/11/2010	Year of assessment 2012/13	• 10% in all other cases		
Malaysia	24th	25/4/2012	Year of assessment 2013/14	• 5% if the beneficial owner is a company which holds directly or indirectly at least 10% of the capital of the paying company • 10% in all other cases	• 0% if the interest is received by the Government authorities or other qualifying institutions • 10% in other cases	• 8%

Malta	22nd	8/11/2011	Year of assessment 2013/14	• 0%	• 0% • Late payment penalty charges shall not be treated as interest for the purpose of this article. Interest payments in excess of an arm's length amount will remain taxable according to the laws of each jurisdiction	• 3%
Mexico	25th	18/6/2012	Year of assessment 2014/15	• 0%	• 0% for Government and other recognised financial establishments appointed by the Government and mutually agreed upon by the competent authorities; for a	• 10%

					loan for a period of not less than three years granted by any institutions as may be agreed between the competent authorities • 4.9% if the interest is received by a bank • 10% in all other cases	
New Zealand	17th	1/12/2010	Year of assessment 2012/13	• 0% if the beneficial owner is a Hong Kong company holding directly or indirectly 50% or more of the voting shares in the dividend-paying company and certain other conditions are met	• 0% for interest payments to government and other recognised financial establishments	• 5%

				• 5% if the beneficial owner is a company holding directly at least 10% of the voting shares of the dividend-paying company 15% in all other cases	• 10% in all other cases	
Netherlands	7th	22/3/2010	Year of assessment 2012/13	• 0% if the beneficial owner is a company or a subsidiary of a company regularly traded on a recognised stock exchange which holds directly at least 10% of the capital of the company paying the dividends, or if the beneficial owner is a bank, insurance company, pension fund, headquarter company, political subdivision or a local authority • 10% in all other cases	• 0%	• 3%
Pakistan	37th	17/2/2017	Pending notification	• 10%	• 10%	• 10%

Portugal	19th	22/3/2011	Year of assessment 2013/14	• 5% if the beneficial owner is a company (other than a partnership), which holds directly at least 10% of the capital of the company paying the dividends • 10% in all other cases	• 0% applies to interest payments to the government and certain financial establishment appointed by the government and mutually agreed by the competent authorities of both sides • 10% rate applies to all other cases	• 5%
Qatar	29th	13/5/2013	Year of assessment 2014/15	• 0%	• 0% applies to arm's length interest payments. The excess part of the arm's length amount shall remain taxable according to domestic tax law.	• 5%
Romania	33th	18/11/2015	Income derived on or after 01/01/2017	• 3% or 5%	• 0% if Hong Kong levies no withholding tax on interest	• 3%

					• 3% if Hong Kong levies withholding tax on interest	
Russia	34th	18/01/2016	Year of assessment 2017/18	• 5% or 10%	• 0%	• 3%
Saudi Arabia	38th	24/08/2017	Pending Notification	• 5%	• 0%	• 8% 5% if the royalties are for the use of, or the right to use, industrial, commercial or scientific equipment
South Africa	32nd	16/10/2014	Year of assessment 2016/17	• 5% applies if the beneficial owner is a company which holds directly at least 10% of the capital of the company paying the dividends	• 0% applies to interest payments to the government and certain financial establishment appointed by the government and mutually agreed	• 5%

				• 10% in all other cases	by the competent authorities of both sides • 10% rate applies to all other cases	
Spain	20th	1/4/2011	Year of assessment 2013/14	• 0% applies if the beneficial owner is a company (other than a partnership) which holds directly at least 25% of the capital of the company paying the dividends • 10% in all other cases	• 0% applies to interest payments to the government, the central bank, a political subdivision or local authority thereof; in respect of a loan, debt-claim or credit that is owed to, or made, provided, guaranteed or insured by the government or a political subdivision, local authority or export facilitating	• 5%

					agency; a financial institution and a pension fund. • 5% in other cases • Interest payments in excess of an arm's length amount will remain taxable according to the laws of each jurisdiction	
Switzerland	18th	4/10/2011	Year of assessment 2013/14	• 0% if the beneficial owner of the dividends is a company holding directly at least 10% of the capital of the company paying the dividends, a pension fund or the Hong Kong Monetary Authority • 10% in all other cases	• 0%	• 3%

Thailand	2nd	7/9/2005	Year of assessment 2006/07	• 10%	• 10% if the interest is paid to a financial institution or insurance company, or paid with respect to indebtedness arising from the sale on credit of equipment, merchandise or services • 15% in all other cases	• 5% for literary, artistic and scientific work copyright royalties • 10% for the use or right to use any patent, trademark, design or model, plan, secret formula or process royalties • 15% in all other cases

United Arab Emirates	33rd	11/12/2014	Year of assessment 2016/17	• 0% for Government, its institutions or other entity wholly-owned directly by the Government • 5% in all other cases	• 0% for government and other recognised financial establishments • 5% in all other cases	• 5%
United Kingdom	12th	21/6/2010	Year of assessment 2011/12	• 15% if received from UK Real Estate Investment Trusts • 0% for all other cases	• 0%	• 3%
Vietnam	5th	16/12/2008	Year of assessment 2010/11	• 10%	• 0% if the recipient is the Government and certain recognised Government authorities and institutions	• 7% where payments are made for the use of patent, design or model, plan, secret formula or process
(Protocol)		13/1/2014	Year of assessment 2016/17		• 10% in all other cases	• 10% in all other cases

¶14-1050 Tax credits

A comprehensive double taxation agreement generally eliminates double taxation by the allowance of a tax credit. Section 50 of the *Inland Revenue Ordinance* provides for the allowance of a tax credit if a double tax agreement is entered into.

This section provides that tax payable overseas is to be allowed as a credit against tax payable on the same income in Hong Kong (s 50(1)).

Under the tax credit system provided under s 50, the amount of Hong Kong tax payable on income is reduced by the amount of credit only if the person entitled to the income was a resident in Hong Kong in the relevant year (s 50(2)).

Based on the current Agreement with Mainland China, if a Hong Kong tax resident is deriving income which is subject to tax in Hong Kong, any tax paid in Mainland China on the same income can be allowed as a tax credit against his Hong Kong tax payable to eliminate double taxation.

The amount of the tax credit cannot exceed the amount of tax payable in respect of that income calculated in accordance with the IRO. For example, a Hong Kong company derived income from Mainland and paid Mainland tax. If such income is not arising in Hong Kong, it is not subject to Hong Kong tax. Hence, there is no double taxation issue, and the Mainland tax paid will not be allowed as a tax credit against the company's Hong Kong tax payable on other income.

The total tax credit for foreign tax available to a taxpayer in an assessment year cannot exceed the total amount of tax which is payable by the taxpayer in that year on the same income (s 50(4)). In case the taxpayer is in a tax loss situation and does not have any Hong Kong tax payable for that year of assessment, no tax credit will be allowed for the Mainland tax paid.

Due to the differences in tax rates between Mainland and Hong Kong, the tax paid in Mainland may exceed the amount of the credit limit. The excess is allowed as a deduction. Any Mainland tax paid that is not allowed as a tax credit will not be able to be carried forward as a tax credit in a subsequent year of assessment.

The steps for calculating the Hong Kong tax payable after tax credit are as follows:

1) calculate the assessable profits and compute the Hong Kong tax payable before allowing the tax credit;
2) calculate the tax credit limit;
3) compare the overseas tax paid and the tax credit limit; calculate the excess overseas tax which is not allowable as a tax credit;
4) recalculate the assessable profits by deducting the excess overseas tax paid as an expense and re-compute the Hong Kong tax payable;
5) deduct the tax credit (subject to the limit) from the re-computed Hong Kong tax payable.

Example

The tax credit in respect of tax paid in the Mainland allowable for set off in Hong Kong is calculated in accordance with s 50(3) and 50(5) of the IRO is as follows:

	Hong Kong	China
Total Assessable Profits (Gross)	$50,000	
Including income derived from China on which tax has been paid		$20,000
Tax Rate	16.5%	25%
Tax Payable	$8,250	$5,000

Total tax liability of the two sides before deducting the tax credit:

$8,250 + $5,000 = $13,250

Less: Tax Credit equal to the (lower of the two):	$3,300	

(1) Tax paid in China: $5,000

Or

(2) Tax Credit Limit:

$20,000 x 16.5% = $3,300

Total tax liabilities after allowance of tax credit:	$4,950 (Note)	$5,000

$4,950 + $5,000 = $9,950

According to s 50(5), the excess amount of tax paid in China not allowed as a tax credit would be allowed as a tax deduction as illustrated below:

	$
China tax paid	$5,000
Grossed-up net income from Mainland	
15,000 x 100% / (100% - 16.5%) = $17,964	
Less: Net Income from China =	
20,000 – 5,000 = $15,000	
Tax credit limit for tax paid in China	$2,964
Amount not allowed as tax credit	$2,036

Hong Kong tax payable before tax credit:

	$
[(50,000 – 20,000) + (20,000 – 2,036)] x 16.5%	
= (30,000 + 17,964) x 16.5%	$7,914
Less: Tax credit limit for tax paid in China	$2,964
Hong Kong tax payable after allowance of tax credit	$4,950 (Note)

Subsection 50(9) imposes a time limit for claiming a tax credit. A claim must be made within two years after the end of the year of assessment in which the income arises. Any dispute as to the amount of credit allowed would be subject to objection and appeal in the same manner as an assessment (see Chapter 10 at ¶10-0100ff).

¶14-1100 Exchange of information

In the CDTAs concluded before 2010, Hong Kong adopted the 1995 version of the OECD Model Tax Convention for the Exchange of Information ("EoI") article whereas most other developed economies adopted the 2004 version. Using the 1995 version of EoI article was considered to be a major obstacle in Hong Kong's CDTA negotiation process. Hong Kong has thus amended its legislation to adopt the new EoI article via:

(i) the *Inland Revenue (Amendment) Ordinance 2010* passed on 6 January 2010; and

(ii) the *Inland Revenue (Disclosure of Information) Rules* passed on 3 March 2010.

Both pieces of legislation became effective on 12 March 2010.

By adopting the new EoI article, Hong Kong has an obligation to exchange information in accordance with the provision of a CDTA.

The purpose of the *Inland Revenue (Amendment) Ordinance 2010* was to enable the Inland Revenue Department to collect and disclose a taxpayer's information in response to requests made by treaty partners for their own tax purposes. It amended the law mainly by inserting the following new sections which extended the Revenue's information gathering power:

(i) Section 51(4AA)

Under this section, the power of assessors, inspectors and assistant commissioners under s 51(4) in obtaining full information in regard to any matter that may affect any liability, responsibility or obligation of any person under the *Inland Revenue Ordinance* is extended to any tax of a territory outside Hong Kong if arrangements have been made with the Government of that territory under s 49(1A) and that tax is the subject of a provision of the arrangements that requires disclosure of information concerning tax of that territory.

(ii) Section 51B(1AA)

Under this section, the Commissioner's power to issue search warrant under s 51B is also extended to any tax of a territory outside Hong Kong if arrangements have been made with the Government of that territory under s 49(1A) and the tax concerned is the subject of a provision of the arrangements that requires disclosure of information concerning tax of that territory (further amended under *Inland Revenue (Amendment) (No 2) Ordinance 2013* which was enacted on 19 July 2013).

(iii) Section 80(2D)

Under this section, it is an offence for any person to give incorrect information in relation to any matter affecting the person's own liability to any tax of a territory outside Hong Kong without reasonable excuse if arrangements have been made with the Government of that territory under s 49(1A) and that tax is the subject of a provision of the arrangements that requires disclosure of information concerning tax of that territory. Persons who are in breach of this section are liable to a fine at level 3.

Under the *Inland Revenue Ordinance* as amended by the *Inland Revenue (Amendment) Ordinance 2010*, the Inland Revenue Department was only empowered to exchange tax information in relation to taxpayers with tax authorities in other jurisdictions which have entered into CDTAs with Hong Kong.

Enacted on 19 July 2013, the *Inland Revenue (Amendment) (No 2) Ordinance 2013* provided a legal framework for standalone tax information exchange agreements ("TIEAs") between Hong Kong and other jurisdictions as well as expanded the scope of information that can be exchanged under CDTAs. The provisions in the above Ordinance are summarised as follows:

(i) Section 49(1B)

This provision enables Hong Kong to enter into arrangements with foreign territories not only for the purpose of concluding a CDTA but also for the purpose of exchange of information. Further, the exchange of information can relate to any tax imposed by the laws of Hong Kong or the foreign territories.

(ii) Sections 51(4), 51(4A) and 52(1)

These sections empower the Commissioner of Inland Revenue to request information not only in possession of a taxpayer but also in control of a taxpayer.

The Inland Revenue Department stated its view on what amounts to "possession" and "control" of a taxpayer in para 16 of DIPN No 47 (Revised). The Inland Revenue Department has also revised DIPN No 47: "Exchange of Information" in January 2014 to set out the practice of the Department on the processing and exchange of tax information upon requests received from treaty and presumably, future TIEA partners.

The *Inland Revenue (Disclosure of Information) Rules* (Disclosure Rules) were intended to provide the taxpayers with a set of fair procedures to protect their confidentiality and privacy rights.

The Disclosure Rules, in line with DIPN No 47 (Revised) (paras 62 to 86), provide the following:

- A disclosure request may only be approved by certain officers of the Inland Revenue Department personally. The Disclosure Rules set out the criteria to be applied in making the decision and the approving officer had to ensure that the disclosure request complies with certain provisions and procedures.
- Unless exceptional circumstances exist, the Commissioner must, prior to the disclosure of any information in response to a disclosure request, notify the person to whom the information requested is related in writing about the disclosure.
- Under Rule 3 of the Disclosure Rules, the authorised officer must be personally satisfied that the disclosure request complies with the following provisions or procedures before he/she may approve the request:

  (a) the provisions of the relevant arrangements that are applicable to the request;

  (b) any procedures applicable to the request that may be specified in any instrument that amends or supplements the relevant arrangement;

  (c) the particulars prescribed in the Schedule to the Disclosure Rules.
- Under Rule 4 of the Disclosure Rules, the Commissioner of Inland Revenue is empowered to disclose information that relates to the carrying out of the relevant arrangements, or to tax assessment, in respect of any period that starts after the arrangements have come into place.

On 25 March 2014, Hong Kong signed its first TIEA with the United States that provides for exchange of information by the Inland Revenue Department upon request made by the United States in relation to the assessment or enforcement of tax matters. Instead of including the exchange of information provision as part of the CDTAs signed by Hong Kong with other jurisdictions previously, TIEAs provide for exchange of information on a standalone basis.

Hong Kong also signed agreements with six Nordic jurisdictions (namely, Denmark, the Faroes, Greenland, Iceland, Norway and

Sweden) on 22 August 2014 for exchange of information relating to taxes. The TIEAs came into force on the following dates, after the ratification procedures by Hong Kong and the respective Nordic jurisdiction were completed.

Nordic Jurisdictions	*Date of Entry into Force*
Denmark, the Faroes, Iceland and Norway	4 December 2015
Sweden	16 January 2016
Greenland	17 February 2016

The need for exchange of information for tax purposes is a topic which has received increasing attention since the Global Financial Crisis. On 20 July 2013, the G20 countries mandated the OECD to develop a worldwide standard for the Automatic Exchange Of Information (AEOI).

The OECD proposals for AEOI were released on 13 February 2014. These proposals have since been endorsed by the majority of jurisdictions around the world, including by Hong Kong. Subsequent to the Hong Kong Government's consultation on the proposed model for implementing AEoI as promulgated by the OECD, the Inland Revenue (Amendment)(No. 3) Ordinance 2016 has come into effect on 30 June 2016 and Hong Kong will start identifying partners from among the 42 jurisdictions which have signed comprehensive avoidance of double taxation agreements or tax information exchange agreements with Hong Kong. The Amendment Ordinance has put in place a legal framework for Hong Kong to implement AEoI with selected jurisdictions by the end of 2018. The Inland Revenue (Amendment) (No. 2) Ordinance 2017 was gazetted on 16 June 2017 and has come into effect on 1 July 2017. This enables Hong Kong to implement AEoI more effectively by expanding the list of "reportable jurisdictions" under the Inland Revenue Ordinance to cover 75 jurisdictions, comprising 13 confirmed AEoI partners and 62 prospective AEoI partners. The 13 AEoI partners are Belgium, Canada, Guernsey, Indonesia, Ireland, Italy, Japan, Korea, Mexico, the Netherlands, Portugal, South Africa and the United Kingdom.

Under the AEoI framework, a financial institution is required to identify financial accounts held by tax residents in these 75 reportable jurisdictions in accordance with the OECD due diligence procedures, collect the reportable information of these financial accounts and furnish such information to IRD starting from 2018 (2019 for Korea). "Tax residents of reportable jurisdictions" refer to those who are liable to tax by reason of residence in the jurisdictions. In general, whether or not an individual is a tax resident of a jurisdiction is determined by having regard to the person's physical presence or stay in a place (e.g. whether over 183 days within a tax year) or, in the case of a company, the place of incorporation or the place where the central management and control of the entity is exercised. The IRD will then exchange the information with tax authorities of AEoI partner jurisdictions on an annual basis.

Hong Kong's commitment to support is premised on the conditions that AEoI is conducted on a reciprocal basis with appropriate partners which can meet relevant requirements on protection of privacy, confidentiality of information exchange and ensuring proper use of data. The IRD intends to conduct AEoI with signatories of CDTAs and TIEAs with Hong Kong on a bilateral basis. Unlike most of the jurisdictions committed to AEoI, Hong Kong is not covered by Multilateral Convention. The Government is actively considering the possibility of extending the application of the Multilateral Convention to Hong Kong so as to facilitate expansion of the AEoI network.On 3 July 2017, an AEoI Portal was launched for financial institutions to furnish notifications and file returns. Financial institutions have to register under the Portal and use their e-Cert for the purposes of authentication and confidentiality of data.

¶14-1150 Hong Kong/China double taxation arrangements

In order to minimise double taxation of cross-border activities between Mainland China and the Hong Kong Special Administrative Region, the Central People's Government and the Hong Kong Special Administrative Region Government signed the *Arrangement for the Avoidance of Double Taxation on Income and Prevention of Fiscal Evasion* ("the new arrangement") on 21 August 2006. This new arrangement extended the scope of the *Arrangement between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation on Income* ("the original arrangement") which was entered into by China and Hong Kong in February 1998.

To give effect to the original and new arrangements, two *Specification of Arrangement Orders* were made by the Chief Executive in Council on 24 February 1998 and 27 October 2006, respectively, under s 49 of the *Inland Revenue Ordinance*. In order to clarify uncertainties arising from the original and new arrangements, DIPN No 32 and No 44 were issued in June 1998 and December 2006 respectively. DIPN No 44 was further revised in April 2007 and August 2008. DIPN No 32 was revised in October 2011.

Effective dates

The original arrangement applies:

- in Mainland China, in respect of income derived on or after 1 July 1998; and
- in Hong Kong, in respect of income derived in any year of assessment commencing after 1 April 1998.

The new arrangement took effect and replaced the original arrangement:

- with respect to Mainland taxes, from the taxable year beginning on or after 1 January 2007; and
- with respect to Hong Kong taxes, from the year of assessment beginning on or after 1 April 2007.

Scope of the Arrangement

The taxes to which the new arrangement applies are:

- in Mainland China, individual income tax, foreign investment enterprises income tax and foreign enterprises income tax; and
- in Hong Kong, profits tax, salaries tax, property tax, whether or not charged under personal assessment.

The new arrangement is broader in scope than the original arrangement. In addition to the business profits of permanent establishments, income from shipping, land and air transportation and income from personal services, the new arrangement also covers income from dividends, interest, royalties and capital gains.

Double taxation relief

Double taxation relief is provided under the new arrangement as follows:

Category	*Relief provided under arrangement*
Business profits (Art 7)	The profits of an enterprise of one side are taxable only in that side unless the enterprise carries on business in the other side through a permanent establishment situated there. Where an enterprise carries on business through a permanent establishment in the other side, the enterprise may be taxed in the other side but only to the extent that its profits are attributable to the permanent establishment.

Category	*Relief provided under arrangement*
	No profits will be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for that enterprise.
Permanent establishment (Art 5)	"Permanent establishment" includes a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry or any other place of extraction of natural resources, a building site, a construction, assembly or installation project or connected supervisory activities lasting more than six months, the furnishing of services, including consultancy services totaling more than six months (this was replaced by 183 days in the Second Protocol to the Agreement for the Avoidance of Double Taxation signed on 30 January 2008 that took effect on 11 June 2008) within any 12-month period commencing or ending in a taxable year. It does not include the use of facilities or the maintenance of a fixed place of business solely for the storage, display or delivery of goods, the purchase of goods, advertising, collecting information or other preparatory or ancillary activities. However, if a person, other than an agent of independent status, habitually exercises an authority to conclude contracts on behalf of an enterprise in one side, then the enterprise will be regarded as having a "permanent establishment" in that side.
Shipping, air and land transport (Art 8)	Income arising from the operation of ships, aircraft or land transport vehicles by a Hong Kong enterprise operating in China is exempt from tax in China (including enterprise income tax and value added tax) (and vice versa). This relief applies equally to revenue and profits derived from participation in a partnership business, a joint business or an international business agency.
Income from employment (Art 14)	Employment income derived by a resident of one side is taxable in that side unless the employment is exercised in the other side. Remuneration derived by a resident of one side in respect of an employment exercised in the other side will be exempt from individual income tax in that side provided that:

Category	*Relief provided under arrangement*
	(1) the taxpayer stays in the other side for a period or periods not exceeding in the aggregate 183 days in any 12-month period commencing or ending in the taxable period concerned; (2) the remuneration is paid by or on behalf of an employer who is not a resident of the other side; and (3) the remuneration is not borne by a permanent establishment which the employer has in the other side.
Directors' fees; artistes and sportspersons (Arts 15 and 16)	The relief provided under Arts 7 and 14 does not apply to directors' fees or income derived by artistes and sportspersons. Directors' fees and similar payments received by a resident of one side in his or her capacity as a board of directors of a company which is a resident of the other side may be taxed in that other side. Income derived by a resident artiste or sportsperson of one side from personal activities exercised in the other side may be taxed in that other side.
Dividends (Art 10)	The side of residence has the right to tax dividends. The side of source may also tax dividends according to the laws of that side. However, the tax so charged shall not exceed 10% of the gross amount of the dividends, and 5% of the gross amount of the dividends if the beneficial owner is a company directly holding at least 25% of the capital of the company paying the dividends. Dividends is defined as "income from shares or other rights, not being debt-claims, participating in profits" and "income from other corporate rights which is subjected to the same taxation treatment as income from shares under the laws of the side of which the company making the distribution is a resident". As non-residents are not subject to tax in respect of dividends paid by a Hong Kong company, the limitation of tax rates has no practical application in Hong Kong, but this will provide protection for Chinese investors in the case that the exemption is withdrawn in the future.

Category	*Relief provided under arrangement*
Interest (Art 11)	The source of interest is the side in which the interest arises. The limitation of tax rates in the side in which the interest arises is a maximum of 7% of the gross amount of the interest. Interest received by the Government of the other side or any recognised institutions is exempt from tax in the side of source. Interest is defined as "income from debt-claims of every kind, whether or not it is secured by mortgage or whether or not it carries a right to participate in the debtor's profits."
Royalties (Art 12)	The provisions of this article and the criteria for determining the locality of the source are the same as those for Art 11. The tax rate is limited to 7% of the gross amount of the royalties. For royalties paid to an aircraft and ship leasing business, the tax charged shall not exceed 5% of the gross amount of the royalties. As the applicable tax rate of 7% under the arrangement is higher than the tax rates under ss 15(1)(a), (b) and (ba) and 21A(1)(b) of the *Inland Revenue Ordinance*, royalties arising in Hong Kong and paid to a resident of the Mainland will be taxed at the effective rates of 4.95% (ie for corporations at a tax rate of 16.5% on 30% of the gross amount) or 4.5% (ie for persons other than corporations at a tax rate of 15% on 30% of the gross amount) instead of the rate as provided for in the arrangement.
Capital gains (Art 13)	Exemption on capital gains derived from the alienation of shares in a Mainland company, provided that the shares sold are less than 25% of the entire shareholding of the Mainland company and the assets of the Mainland company are not comprised, directly or indirectly, mainly of immovable property situated on the Mainland. Please refer to below on the effect of the Second Protocol to the Agreement for the Avoidance of Double Taxation that took effect on 11 June 2008 on capital gains.
Elimination of double taxation (Art 21)	Taxes paid on one side shall be allowed as a credit against taxes paid on the other side. The amount of the credit shall not exceed the amount of tax payable on the other side in respect of that item of income.

Inland Revenue Department's interpretation under DIPN No 44

DIPN No 44 was issued by the Inland Revenue Department in December 2006 and revised in April 2007 and August 2008 to clarify any uncertainties under the new arrangement. The main points are discussed below.

Article 4 — Resident

The arrangement applies to a person who is a resident of either side or a resident of both sides.

The term "resident individual" in Hong Kong means (DIPN No 44, para 21):

(i) an individual who ordinarily resides in Hong Kong;

(ii) an individual who stays in Hong Kong for more than 180 days during the relevant year of assessment or for more than 300 days in two consecutive years of assessment (one of which is the relevant year of assessment).

An individual "ordinarily resides" in Hong Kong if he or she has a permanent home in Hong Kong where he or she or his or her family lives. Factors such as the duration of stay in Hong Kong, whether he or she has a permanent place of residence in Hong Kong, owns any property overseas for residential purposes, and whether he or she primarily resides in Hong Kong or overseas will also be taken into consideration.

If an individual is a resident of both sides, the order of priority to determine his or her status under the arrangement is as follows:

(i) he or she shall be deemed to be a resident only of the side in which he or she has a permanent home available to him or her; if he or she has a permanent home in both sides, he or she shall be deemed to be a resident only of the side with which his or her personal and economic relations are closer ("centre of vital interests");

(ii) if the centre of vital interests cannot be determined, or if he or she does not have a permanent home available to him or her in either side, he or she shall be deemed to be a resident only of the side in which he or she has an habitual abode;

(iii) if he or she has an habitual abode in both sides or in neither of them, the competent authorities of both sides shall resolve the issue by mutual agreement.

The term "permanent home" mentioned above refers to a home owned or possessed by an individual that is permanent in nature (DIPN No 44, para 25).

For a company, it will be considered to be a resident of Hong Kong if:

(i) it is incorporated in Hong Kong; or

(ii) if it is incorporated outside Hong Kong, is normally managed or controlled in Hong Kong.

DIPN No 44 states that the concept of "normally managed or controlled in Hong Kong" has a broader meaning than "central management and control" established in case law as it does not require that both management and control be exercised in Hong Kong. "Management" under the arrangement refers to management of daily business operations, or implementation of the decisions made by top management. "Control" refers to control of the whole business at the top level, including formulating the central policy of the business, making strategic policies of the company, choosing business financing, evaluating business performance, etc, and is usually exercised by the board of directors (DIPN No 44, para 27).

If a company is qualified to be a resident of both sides, the company shall be deemed to be a resident only of the side in which its place of effective management is situated. "Place of effective management" refers to the place where key management and strategic decisions that are necessary for the conduct of the company's business are in substance made, ie the place where the most senior persons of a company formulate the direction and work plans of the company (DIPN No 44, paras 29 and 30).

A person other than individuals and companies (eg partnership and trust) that is constituted under the laws of Hong Kong, or, if constituted outside Hong Kong, is normally managed or controlled in Hong Kong, will be considered to be a resident of Hong Kong.

On the administrative side, DIPN No 44 states that a certification of resident status may be required by the tax authority of the Mainland in applying the arrangement. Details of the information required and the relevant certification forms are published on the Inland Revenue Department's website. Pursuant to the Announcement [2015] No 60 issued by the State Administration of Taxation of the Mainland China, effective from 1 November 2015, a certification of resident status should be submitted by the taxpayer when filing a tax return or by the withholding agent when making the withholding declaration.

Article 5 — Permanent establishment

In addition to the definition provided under the new arrangement on what constitutes a "permanent establishment", DIPN No 44 has further elaborated on this aspect. A permanent establishment will normally have the following features:

(1) it must be a place of business. This may include a house, a site, a warehouse, a stall, equipment or facilities for the purpose of carrying out business activities, whether owned or rented by the enterprise;

(2) it must be a fixed place of business of a permanent nature. The temporary interruption or suspension of business activities conducted at a fixed place of business would not affect the existence of a permanent establishment; and

(3) the enterprise must carry on the whole or a part of its business activities at the place of business (para 36).

However, it is interesting to note that for Hong Kong manufacturers operating factories in Mainland China under a processing arrangement, DIPN No 44 states that "according to the provisions of the Comprehensive Arrangement, the Hong Kong manufacturer could be regarded as having a permanent establishment in the Mainland and is therefore liable to tax there" (para 7). However, despite the fact that the arrangement should not affect existing concessional practices in Hong Kong, and it is not the present intention of the Mainland to change the way it taxes profits derived from this type of operation, the possibility that profits attributable to the permanent establishment may be taxed in accordance with the arrangement in future cannot be ruled out.

Concerning a building site, a construction, assembly or installation project or the connected supervisory activities, a Hong Kong enterprise will not be regarded as having a permanent establishment in the Mainland if contracting work carried out in the Mainland does not last more than six months, and vice versa. In counting the period for which a project is carried out, the Inland Revenue Department is of the view that the period is counted from the date the contractor commences work (including all preparatory activities) up to the date the work is completed and handed over to the user. Moreover, where, after commencement of work, a project is suspended, the project would not normally be treated as terminated. The duration of the project would be counted continuously with no deduction for the days the project is suspended (paras 38–40).

In case of provision of consultancy services, DIPN No 44 states that the scope of consultancy services includes:

(1) improvement of existing production facilities and products, selection of technical know-how, or enhancement of supervisory and management skills, etc; and

(2) feasibility studies of investment projects and the selection of design plans (para 42).

For the purpose of counting the period for which the consultancy services are rendered, it should be commenced within any month during the course of a service contract (para 43). Furthermore, the Second Protocol to the Agreement for the Avoidance of Double Taxation has substituted "183 days" for "6 months" so that both Hong Kong and the Mainland would use the same counting method from 11 June 2008.

In defining a permanent establishment, the arrangement excludes a fixed place of business whose activities are purely of a preparatory or auxiliary character for the enterprise. DIPN No 44 confirms that genuine "representative offices" are not regarded as permanent establishments provided that:

(1) the activities should be for the enterprise itself;

(2) the activities should not directly generate profits; and

(3) the function of the place of business should only be of a supportive nature. If the place of business conducts certain supervisory management functions for the enterprise or manages certain business operations, its activities would not be regarded as being of the required character. In this event, the place of business would be regarded as a permanent establishment (para 46).

Article 7 — Business profits

Business profits refer to profits derived by an enterprise from its business activities. The term business profits may include income such as profits derived from immovable property, dividends and interest. Taxation of these categories is governed by other articles of the arrangement.

Article 7 provides that the profits of an enterprise of one side shall be taxable only in that side unless the enterprise carries on business in the other side through a permanent establishment situated there. In this case, the profits may be taxed in that other side, but only to the extent that is attributable to that permanent establishment.

The arrangement sets out some principles which must be followed in computing business profits. In Hong Kong, assessable profits are based on profits computed by enterprises in accordance with the prevailing generally accepted principles of commercial accounting as adjusted in conformity with the provisions of the Ordinance (DIPN No 44, para 56).

Paragraph 2 of Art 7 provides that where a permanent establishment situated in the other side carries on business with the head office or other offices of the enterprise of which it is a permanent establishment, it should do so on an arm's length basis.

Paragraph 3 of Art 7 provides that expenses that are incurred for the purposes of producing the relevant profits will be allowed as deductions in computing the profits of a permanent establishment. Relevant expenses which are clearly attributed to that permanent establishment can be deducted. Otherwise, an allocation of the relevant expenses should be made. Such allocation can be based on the proportion of the business turnover or gross profit of the permanent establishment to that of the enterprise (DIPN No 44, para 59).

As a permanent establishment and its head office are one and the same legal entity, Art 7 sets out three categories of amounts paid to the head office of the enterprise or any of its other offices which will not be allowed as deductions in determining the profits of a permanent establishment:

- by way of royalties, remuneration, fees or any other similar payments in return for the use of patents or other rights;
- by way of commission for specific services performed or for management; or
- by way of interest on moneys lent to the permanent establishment, except in the case of a banking enterprise.

Amounts received by the permanent establishment from its head office or any of its other offices under the above three categories will likewise not be included in the determination of its profits (DIPN No 44, para 61).

If the financial statements prepared by an enterprise do not give a true view of the state of affairs of the permanent establishment for determining the profits attributed to that permanent establishment, the enterprise may continue using the method which is customary or any other methods provided for in the laws of the side concerned. However, such a method must be in accordance with the principles contained in Art 7 (DIPN No 44, para 62).

For banks and other persons whose head offices are situated outside Hong Kong, para 63 of DIPN No 44 provides that Rules 3 and 5 of the *Inland Revenue Rules* provide methods for determining the profits of branches and permanent establishments in Hong Kong, if their true profits arising in or derived from Hong Kong are not disclosed in the financial statements.

Article 8 — Shipping, air and land transport

For shipping transport, DIPN No 44 clarifies that profits derived by a Hong Kong shipping enterprise from its shipping business will be taxed in Hong Kong alone and the exercise of the taxing rights is subject to the provisions of s 23B of the *Inland Revenue Ordinance*.

Sums from relevant carriage shipped aboard a registered ship at any location within the waters of Hong Kong and proceeding to sea therefrom by a Hong Kong shipping enterprise will continue to be exempt from tax in Hong Kong (DIPN No 44, para 68).

For air transport, profits derived by a Hong Kong air transport enterprise from its air transport business will be taxed in Hong Kong alone.

However, by virtue of s 23C(2A), sums from relevant carriage and charter hire from the Mainland derived by a Hong Kong air transport enterprise that are exempt from tax in the Mainland under the arrangement are included as relevant sums in calculating profits chargeable to tax in Hong Kong (DIPN No 44, para 69).

For land transport, the application is to a Hong Kong enterprise that carries on a business of land transport pursuant to s 14 of the *Inland Revenue Ordinance*. A Hong Kong land transport enterprise will only be subject to tax in Hong Kong and will be exempt from enterprises income tax and business tax in the Mainland.

In the case of a cross-border land transport business which takes the form of a co-operative enterprise, DIPN No 44 states that the respective share of profits derived by each participant from the joint business operation will be exempt from tax by the other side and will be taxed on the side of which the participant is a resident in accordance with its taxation laws (DIPN No 44, para 72).

Article 9 — Associated enterprises

Under this article, taxation authorities may make transfer pricing adjustments in cases where the transactions between associated enterprises have not been entered into on an arm's length basis.

The profits understated by an enterprise due to transactions that have not been entered into on an arm's length basis may be included in the profits of that enterprise and taxed as such in the following two situations (DIPN No 44, para 74):

(1) an enterprise of one side participates directly or indirectly in the management, control or capital of an enterprise of the other side; or

(2) the same person participates directly or indirectly in the management, control or capital of an enterprise of one side and an enterprise of the other side.

Articles 10, 11 and 12 — Dividends, interest and royalties

For investment income, including dividends, interest and royalties, the arrangement specifically states that such income should be taxed in the side of source according to its laws. The side of residence also has the right to tax the same item of investment income and is required to provide relief to its residents to avoid double taxation on the same income (DIPN No 44, para 81).

The relevant provisions of the arrangement set limits on the tax rates that the side of source may impose. In addition, notwithstanding the provisions of any domestic laws of the side of source, the tax imposed on investment income derived by a resident of the other side (ie the beneficial owner) should not exceed the rate provided for in the arrangement. A certificate of Resident Status is a document issued by the IRD to a Hong Kong resident who requires proof of resident status for the purpose of claiming tax benefits under the Double Tax Arrangement. The side of source will only limit its right to tax if the beneficial owner of the investment income is a resident of the other side (DIPN No 44, paras 81 and 82).

An agent or a nominee who collects the investment income on behalf of the actual owner and subsequently transfers the income to the actual owner will not be deemed to be the beneficial owner of the income. In this regard, even though an agent or a nominee is a resident of the other side, the side of source does not need to apply the tax limitation if the beneficial owner is not a resident of the other side. On the other hand, as long as the beneficial owner is a resident of the other side, the limitation of tax on the income in the side of source remains applicable, regardless of whether the agent or nominee is a resident of the other side at the time of the receipt of the relevant income (DIPN No 44, paras 82 and 83).

It should be noted that the provisions of Art 7 shall apply if the beneficial owner of the investment income (being the Government of one side, a local authority thereof or a resident of that side) carries on business in the other side through a permanent establishment situated therein, and the relevant property in respect of which the income is paid is effectively connected with that permanent establishment (DIPN No 44, paras 88, 93 and 100).

Article 13 — Capital gains

Hong Kong does not impose tax on capital gains. However, under the arrangement, capital gains derived by a resident of Hong Kong from the following activities in Mainland China will be subject to tax:

(i) alienation of immovable property situated in Mainland China;

(ii) alienation of movable property forming part of the business property of a permanent establishment which a Hong Kong enterprise has in Mainland China;

(iii) alienation of shares in a company whose assets are comprised, directly or indirectly, mainly (being not less than 50%) of immovable property situated in Mainland China;

(iv) alienation of shares, other than those referred to in item (iii) above, representing 25% or more of the entire shareholding of a Mainland company.

This Article provides tax relief to investors in respect of the sale of minority interest in a Mainland company.

Under item (iii), there will be an exemption from capital gains tax in the Mainland in the case of the sale of shares by a Hong Kong resident in a Mainland company whose assets are not directly or indirectly comprised mainly of immovable property situated on the Mainland. However, the Mainland and Hong Kong held different views as to the point in time at which the value of immovable property equals or exceeds 50% of the value of the total assets of the company. The Second Protocol to the Agreement for the Avoidance of Double Taxation which came into effect on 11 June 2008 clarifies that where a Hong Kong resident derives capital gains from the alienation of shares in a Mainland company whose assets within three years prior to the alienation comprised immovable properties amounting to at least 50% of the total assets of the company, such gains would be subject to tax in the Mainland.

In relation to item (iv), there will be an exemption from capital gains tax in the Mainland in the case of the sale of shares in a Mainland company if the shares sold are less than 25% of the shareholding of the Mainland company. The Second Protocol to the Agreement clarifies that a Hong Kong resident's capital gains derived from the alienation of shares in a Mainland company would be subject to tax in the Mainland if it owned 25% or more of the shareholding in that Mainland company at any time during the 12-month period prior to the alienation.

The Fourth Protocol to the Agreement mentioned that gains derived by a resident of Hong Kong from the alienation of shares of a company that is a resident of the Mainland quoted on a recognized stock exchange shall be taxable only in Hong Kong. The alienation is limited to cases where the shares are bought and sold on the same stock exchange.

Article 14 — Income from employment

It should be noted that "any 12-month period commencing or ending in the taxable period concerned" indicates that the number of days of presence may straddle over two years and that a floating calculation method may be adopted. In the first year of application of this article, any 12-month period means any 12-month period commencing in the period from 1 January 2007 to 31 December 2007 for the Mainland and any 12-month period commencing in the period from 1 April 2007 to 31 March 2008 for Hong Kong (DIPN No 44, paras 110 and 112).

In this regard, to qualify for the exemption from individual income tax in the Mainland for the year ending 31 December 2008, an individual should not spend more than 183 days in the Mainland in any 12-month period between 2 January 2007 and 30 December 2009. Likewise, to qualify for the exemption from salaries tax in Hong Kong for 2007/08, an individual should not spend more than 183 days in Hong Kong in any 12-month period between 2 April 2006 and 30 March 2009.

A consensus has been reached between Hong Kong and China to generally adopt the number of physical presence days as the basis for allocation of taxable income for the purpose of calculating individual income tax between the two tax jurisdictions.

Article 21 — Method of tax relief

The arrangement provides for tax relief to be given in the form of tax credits. Where qualifying income is subject to tax in the Mainland and the same income is subject to tax in Hong Kong, the Mainland tax paid will be credited against the Hong Kong tax payable (and vice versa). The amount of credit in both cases, however, will not exceed the tax computed in respect of that income under each side's respective taxation laws and regulations.

The arrangement provides that the method for elimination of double taxation adopted in Hong Kong will be subject to the provisions of the Ordinance relating to the allowance of a deduction and a credit (ie s 50). DIPN No 44 clarifies that if income derived by a Hong Kong resident from the Mainland does not arise in Hong Kong, it will not be chargeable to tax in Hong Kong, eg in the case of a Hong Kong manufacturer whose profits are apportioned on a 50:50 basis, only half of the profits will be taxed in Hong Kong. In such circumstances, where tax has been paid in the Mainland in respect of half or less than half of the profits, such tax cannot be allowed as a credit against the Hong Kong tax payable. If more than one half of the profits are regarded by the Mainland as profits derived therefrom according to the new arrangement, then the tax paid in the Mainland in respect of such profits, in excess of one half of the total profits, will be allowed as a credit against the tax payable in Hong Kong.

DIPN No 44 sets out detailed methods and bases of computing tax credits.

DIPN No 44 also clarifies that there is no carryover of foreign tax credits. In other words, if a Hong Kong resident suffers a loss in a year of assessment and does not pay any Hong Kong tax, the tax paid by him or her in the Mainland will not be allowed as a credit, either in the current or future years.

A claim for a tax credit should be made within two years after the end of the relevant year of assessment. The claim can be submitted with the tax return for the relevant year of assessment or made separately in writing.

Any dispute over the allowance of a tax credit will be dealt with in accordance with the objection and appeal provisions of the *Inland Revenue Ordinance*.

Article 24 — Exchange of information

The arrangement contains an "exchange of information" article in line with international practice. This Article allows the competent authorities of both sides to exchange such information as is necessary for carrying out the provisions of the arrangement or of the domestic laws of both sides concerning taxes covered by the arrangement.

The arrangement also stipulates that this Article is not construed so as to impose on one side the obligation to carry out administrative measures at variance with the laws and the administrative practice of either side, to supply information which is not obtainable under the laws or in the normal course of the administration of either side, or to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would be contrary to public policy.

Hong Kong signs the Third Protocol to the arrangement with the Mainland on 27 May 2010 to update the "exchange of information" article in the arrangement to the 2004 OECD Model version of the EoI article. The Article requires the contracting parties, upon receiving a request for information, to exchange information even when there is no domestic tax interest involved (see ¶14-5000). The Third Protocol has come into force in December 2010.

Further to the Third Protocol signed between Hong Kong and China on 27 May 2010, the Fourth Protocol was signed on April 2015 in Hong Kong with several important amendments. The Fourth Protocol clarifies the conditions where gains from disposal of shares in a company would be exempted from tax in China and shall be taxable only in Hong Kong. Furthermore, the Fourth Protocol expands the scope of taxes type covered under the EoI article from Individual Income Tax and Corporate Income Tax to Value Added Tax, Business Tax, Consumption Tax, Land Value Added Tax and Property Tax, such arrangement strengthen Hong Kong's obligation to enhance tax transparency and cooperation between tax administrations.

So far, Hong Kong has been following the information exchange framework under either comprehensive double tax agreement or tax information exchange agreements (TIEAs), of which information would only be exchanged upon request. However, further to the release of a new global standard for automatic exchange of financial account information ("AEoI") by the OECD in February 2014, followed with more than 90 jurisdictions have since then committed to the adoption of the new standard, under this global move to AEoI and the increase pressure on greater transparency as advocated under Base Erosion and Profit Shifting ("BEPS"), on 24 April 2015, the Hong Kong Special Administrative Region Government finally launched a two-month public consultation on a proposal to apply, with adaptations for Hong Kong, the prevailing international standards on AEoI in tax matters.

Under the OECD standard promulgated in July 2014, financial institutions such as banks, insurance companies and brokers are required to identify and keep information on their non-Hong Kong tax resident account holders in accordance with the due diligence procedures prescribed and report the information to the Inland Revenue Department. The department will pass the information to AEoI partners on an annual basis.

The Hong Kong Special Administrative Region Government has drawn up proposals to apply AEoI requirements to Hong Kong through legislation. The plan is to start the first information exchanges by the end of 2018.

¶14-2000 Relief from double taxation due to transfer pricing or profit reallocation adjustments

The Inland Revenue Department has issued DIPN No 45: Relief from double taxation due to transfer pricing or profit reallocation adjustments in April 2009 to set out its views and practices on granting relief from double taxation due to a transfer pricing or profit reallocation adjustment under a double tax agreement.

The views and practices of the Inland Revenue Department on transfer pricing enforcement and related matters are set out in DIPN No 46: Transfer pricing guidelines — Methodologies and related issues, issued in December 2009 (see ¶13-3700).

Under DIPN 45, there are two types of international double taxation recognised by the Hong Kong tax authority: economic double taxation and juridical double taxation.

¶14-2100 Economic double taxation

Economic double taxation arises when two enterprises, as residents in different states, are assessed tax on the same profit or income without relief provided by either state for tax imposed by the other. This double taxation may arise as a consequence of non–arm's length transactions. The profits of one enterprise are adjusted upwards increasing the tax charged on that enterprise in one state (ie a primary transfer pricing adjustment), without a corresponding downward adjustment to the tax payable of the associated enterprise in the other state (DIPN No 45, para 3).

The Associated Enterprises Article in the Double Taxation Agreements (DTAs) of Hong Kong, which is modelled on Art 9 of the OECD

Model Tax Convention on Income and on Capital (the OECD Model), provides for primary transfer pricing adjustments by a DTA state and also provides a mechanism for relief from the resultant economic double taxation (DIPN No 45, para 5).

If the transfer pricing adjustment by a DTA state is agreed by the Commissioner to be correct both in principle and amount, the relevant assessment of the Hong Kong enterprise will be revised in accordance with the relief provision in the Associated Enterprises Article of the DTA and s 79 of the *Inland Revenue Ordinance* to refund the excess tax paid or to reduce the tax that would otherwise be payable on the assessable profits of the Hong Kong enterprise. The Hong Kong enterprise must make the claim for an "appropriate adjustment to the amount of tax charged" under s 79 within six years of the end of the relevant year of assessment (DIPN No 45, paras 14 and 15).

Example

Company F, a company resident in Country F which is a DTA state, provided goods for no consideration to its wholly owned subsidiary, Company HK, a company resident in Hong Kong. Country F subjected Company F to tax audit and increased the profits of Company F by $100,000 on the basis that if Company F and Company HK had transacted with each other on an arm's length basis, Company HK would have paid Company F $100,000 for the goods. The resultant economic double taxation may be relieved by:

(i) the Commissioner agreeing that $100,000 reflects an arm's length price and reduces the profits and tax payable by Company HK accordingly; or

(ii) the tax administration of Country F being convinced that its adjustment is incorrect and accordingly reduces the additional tax payable by Company F; or

(iii) the reaching of agreement between both competent authorities on the extent of adjustment under the Mutual Agreement Procedure Article of the relevant DTA.

¶14-2200 Juridical double taxation

Juridical double taxation occurs where an enterprise is charged to tax on the same profit or income in two different states (eg when a single legal entity having a head office in its state of residence has a permanent establishment in another state), without either state providing relief for tax imposed by the other. This double taxation may arise when the profits that are taken to have arisen from the enterprise's operations in a state are adjusted upwards to increase the tax payable in that state (ie a primary profit reallocation adjustment) without a corresponding downward adjustment to the enterprise's profits from its operations in the other state (DIPN No 45, para 4).

Juridical double taxation suffered by a Hong Kong enterprise arising from the application of the domestic tax law of the source DTA state can be relieved by way of a tax credit under s 50 of the *Inland Revenue Ordinance* for the foreign tax paid. Any claim for allowance by way of tax credit must be made not later than two years after the end of the relevant year of assessment (DIPN No 45, para 36).

Alternatively, if the adjustment by a DTA state is agreed by the Commissioner to be correct both in principle and amount, the taxable profits of the Hong Kong enterprise (ie either a head office or a permanent establishment) will be revised in accordance with the Associated Enterprises Article of the DTA and s 79 of the *Inland Revenue Ordinance*.

The Business Profits Article and the Methods for Elimination of Double Taxation Article under Hong Kong's DTAs, which are modelled on Arts 7 and 23, respectively, of the OECD Model, provide for both primary profit reallocation adjustments and relief from the resultant juridical double taxation (DIPN No 45, para 6).

Example

Company F, a resident in Country F which is a DTA state, lodged tax returns in both Hong Kong and Country F and declared profits of $10 million of which $2 million was attributable to the permanent establishment in Hong Kong. The tax administration of Country F considered there to be non–arm's length dealings between the head office in Country F and the permanent establishment in Hong Kong. Accordingly, the profits of the permanent establishment in Hong Kong were reduced to $1 million. If Country F has a tax credit system, it would disallow credits for Hong Kong profits tax paid on $1 million. If it had an exemption system, Country F would reduce the amount of Company F's exempt income to $1 million. The resultant juridical double taxation may be relieved by:

(i) the Commissioner agreeing that the arm's length profits of the permanent establishment should have been $1 million and reducing the tax payable of the permanent establishment by $165,000 (assuming the profits tax rate is 16.5%); or

(ii) the tax administration of Country F being convinced that its adjustment is incorrect and accordingly reduces the additional tax payable by Company F; or

(iii) an agreement is reached between both competent authorities under the Mutual Agreement Procedure Article of the relevant DTA.

¶14-2300 Adjustments by a non-DTA state

The *Inland Revenue Ordinance* has no relief provisions for economic double taxation arising from a transfer pricing adjustment made by the tax administration of a non-DTA state. In these circumstances, the foreign tax paid is a liability of the associated enterprise in the other state. The adjustment does not affect the profits of the Hong Kong enterprise and therefore no adjustment can be made to the profits of the Hong Kong enterprise (DIPN No 45, paras 9 and 10).

For juridical double taxation that arises for a Hong Kong enterprise that is subject to a profit reallocation adjustment made by a non-DTA state, the profit which has been subject to double taxation will not be excluded from taxation in Hong Kong as the profit has been properly assessed to profits tax as Hong Kong sourced profits. There will also be no relief available by way of a tax credit under s 50 of the *Inland Revenue Ordinance* in the absence of a DTA (DIPN No 45, para 11).

¶14-2400 Mutual Agreement Procedure

The Mutual Agreement Procedure Article in the DTAs of the Hong Kong SAR enables a taxpayer to initiate the procedure where it is considered that the actions of the competent authority of one or both of the states concerned result or will result in taxation not in accordance with the provisions of a DTA (DIPN No 45, para 52). An application for relief under the Mutual Agreement Procedure must be made within three years of the first notification of an action resulting in double taxation.

There are two stages to the Mutual Agreement Procedure. The first stage involves the taxpayer and the competent authority of its residence state. It has three elements:

(i) the presentation of a case by the taxpayer to the competent authority of its residence state;

(ii) consideration by the competent authority whether the case presented is justified; and

(iii) consideration by the competent authority whether it is able to arrive at a satisfactory solution itself (DIPN No 45, para 55).

The second stage involves the endeavours of the competent authorities of both states to resolve the case and commences with the competent authority that has been presented with the case approaching the other competent authority. This stage is recognised by Art 25 of the OECD Model to impose on the competent authorities a duty to negotiate and to use their best endeavours to resolve a case (DIPN No 45, para 66).

¶14-2500 Advance Pricing Arrangement programme

The Inland Revenue Department announced on 3 January 2012 that an advance pricing arrangement ("APA") programme will be launched in April 2012. The Inland Revenue Department rolled out the APA programme in April 2012, and guidelines to the APA programme are contained in DIPN No 48: Advance Pricing Arrangement which was issued in March 2012.

An APA is an arrangement that determines, the result of controlled transactions for a definite period of time in the future, following the arm's length principle, under a defined set of criteria for the determination of the arm's length transfer pricing result of those transactions over the stated fixed period of time. Hence an APA enables a taxpayer to reach agreement in advance with the tax authority(ies) in relation to the transfer pricing arrangement for cross-border transactions between related companies on a going-forward basis, generally for a period of three to five years. This is an effective way to prevent double taxation and will provide taxpayers with a higher level of certainty about their tax position with respect to transfer pricing matters. The benefits of an APA include the following:

- Provides greater certainty on tax liability;
- Ensures a fair application of the arm's length principle;
- Reduces the risk of double taxation; and
- Avoids the risk of audit and penalties.

The APA program rolled out by the Inland Revenue Department at this stage aims to cover bilateral and multilateral APA, but not unilateral APA.

There are five stages to the APA process:

Stage 1: Pre-filing

Stage 2: Formal application

Stage 3: Analysis and evaluation

Stage 4: Negotiation and agreement

Stage 5: Drafting, execution and monitoring

While the indicative timeframe in DIPN 48 for concluding an APA is 18 months from the acceptance of the application, the actual timeframe will depend on the extent of negotiation between the Inland Revenue Department and the other competent authority(ies), and a longer timeframe could be expected for cases involving more complicated controlled transactions, and/or the competent authorities hold a different opinion to the arm's length range proposed by the taxpayers in the APA application.

The below table summarized the current threshold for different controlled transactions:

Controlled Transactions	*Threshold*
Sale and purchases of goods	$80 million per annum
Services	$40 million per annum
Use of intangible properties	$20 million per annum

The same threshold applies whether it is a new application or renewal. While the threshold will be operated consistently, the Commissioner after taking into account the number and relative size of the transactions, the transfer pricing risk and the likely attitude of the DTA partner(s), may relax the eligibility criteria to allow an enterprise access to the APA process (DIPN 48, para 17).

Appendices to DIPN No 48 also contain information such as Content of APA Proposal, Formal Application for a Bilateral/Multilateral APA and information/Requirement for a Bilateral/Multilateral APA Application.

The Commissioner will not charge any fee on enterprises during the APA process but some overseas tax administrations may do so (DIPN No 48, para 4).

The Inland Revenue Department concluded its first bilateral APA with the Netherlands in June 2014, and Hong Kong's second APA with Japan was concluded in January 2015. The Inland Revenue Department has indicated that it remains fully committed to expanding Hong Kong's tax treaty network and timely resolution of APA and MAP cases.

¶14-2600 The Base Erosion and Profit Shifting Initiative (BEPS) and its Implementation in Hong Kong

Overview

In June 2012, G20 Leaders called on the OECD to launch an initiative to review and reform the international tax system, specifically referring to "the need to prevent base erosion and profit shifting."

Base erosion and profit shifting, or BEPS, is a term applied to tax planning strategies which artificially shift profits to low- or no-tax locations where there is minimal economic activities and which result in a low corporate income tax paid. Reform was required in this area to adapt the existing international tax framework and enable it to better respond to the challenges of globalisation. It was perceived that, as a result of globalisation, large corporations had been able to exploit gaps in local tax laws and tax treaties governing the taxation of cross-border income, resulting in double non-taxation of income. All OECD and G20 countries are participating in the project and some developing countries have been added to the list of participants. As of July 2017, 102 jurisdictions are participating members of the BEPS Inclusive Framework, while many of the jurisdictions have enacted domestic legislation.

BEPS Action Plan

The OECD's review considered 15 Actions, looking into the impact of policy changes in each of these key areas and providing suggestions on implementation and timing.

On 5 October 2015, the OECD published final reports as part of the Action Plan and an explanatory statement outlining consensus actions under the BEPS project.

The Action Plan aims to equip governments with the instruments required to deal with BEPS challenges covering the following areas:

Action 1 — Digital Economy

Addresses the tax challenges of the digital economy and identifies the main difficulties that the digital economy poses for the application of existing international tax rules.

Action 2 — Hybrids

Develops model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effects of hybrid instruments and entities (e.g. double non-taxation, double deduction, long-term deferral).

Action 3 — Controlled Foreign Companies (CFCs)

Sets out recommendations to strengthen the rules for the taxation of CFCs, to address concerns over the possibility of creating affiliated non-resident taxpayers and routing income of a resident enterprise through the non-resident affiliate to reduce or avoid taxation.

Action 4 — Interest Deductions

Aims to limit base erosion via interest deductions and other financial payments for example through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income.

Action 5 — Harmful Tax Practices

Aims to identify and counter harmful tax practices, taking into account transparency and substance. The Action Plan will look at developing recommendations on the definition of harmful tax practices, and developing a strategy to expand to non-OECD members.

Action 6 — Prevent Treaty Abuse

Aims to prevent treaty abuse, through developing model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances.

Action 7 — Permanent Establishment Status

Aims to prevent the artificial avoidance of Permanent Establishment ("PE") status, for example through the use of commissionaires structures, by redefining the threshold for creating a PE to prevent base erosion and profit shifting.

Action 8 — Transfer Pricing - Intangibles

The objective is that transfer pricing outcomes should be in line with value creation, by requiring that the attribution of value for tax purposes is consistent with economic activity generating that value.

Action 8 looks specifically at intangibles and will develop rules to prevent base erosion and profit shifting where intangibles are owned by, used by, contributed to or moved among group members.

Action 9 — Transfer Pricing – Risk & Capital

Aims to specifically look at the risks and will develop rules to prevent base erosion and profit shifting by transferring risks among, or allocating excessive capital to group members.

Action 10 — Transfer Pricing – High-risk Transactions

Aims to specifically look at other high-risk transactions and will develop rules to prevent base erosion and profits shifting by engaging in transactions which would not, or would only very rarely, occur between third parties.

Action 11 — BEPS Data Collection

Aims to establish methodologies to collect and analyse data on BEPS and the actions to address it. The OECD intends to do this by developing recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis.

Action 12 — Disclosure of Aggressive Tax Planning

Aims to require taxpayers to disclose their aggressive tax planning arrangements. This will be addressed through the development of recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax administrations and businesses and drawing on the experiences of the increasing number of countries that already have such rules.

Action 13 — Transfer Pricing Documentation

Aims to re-examine transfer pricing documentation and will develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business.

A white paper on transfer pricing documentation was released by the OECD in July 2013, with a discussion draft in January 2014 followed by a public consultation. A report was published in September 2014 containing guidance on transfer pricing documentation and country-by-country reporting ("CbC reporting"). This report proposed a new three tier global standard for transfer pricing documentation, including a common template for country-by-country information to be reported to tax authorities and transfer pricing master and local files. The OECD requires a country-by-country report to be filed no later than 12 months after the last day of the reporting period.

Action 14 — Dispute Resolution

Aims to make dispute resolution mechanisms more effective, through developing solutions to address issues that prevent countries from resolving treaty-related disputes under mutual agreement procedures.

Action 15 — Multilateral Instrument

Aims to develop a multilateral instrument to enable jurisdictions to implement measures developed in the course of the work on BEPS and to amend bilateral tax treaties.

Implementation and timing in Hong Kong

In response to questions raised in the Legislative Council in November 2013, the government advised that it is closely monitoring developments in BEPS, including the country-by-country reporting and transfer pricing on intangibles.

On 20 June 2016, it was announced that Hong Kong would become a BEPS Associate, by joining the Inclusive Framework for the implementation of the BEPS project. The Government committed to implementing four minimum standards under BEPS:

- Countering harmful tax practices
- Preventing treaty abuse
- Transfer pricing documentation
- Enhancing dispute resolution

As of July 2017, the table below sets out a summary of implementation and timing in Hong Kong:

Actions	*Notes on Implementation*	*Expected Timing*
VAT on business to customers digital services (Action 1)	No specific rules are expected as Hong Kong does not impose VAT.	N/A
Hybrids (Action 2)	The Inland Revenue (Amendment) (No. 2) Ordinance 2016 was gazetted on 3 June 2016, clarifying that the tax treatment of Regulatory Capital Securities comprising certain hybrid instruments under Basel III would follow that of debt.	Revised provisions in relation to Regulatory Capital Securities came into effect on 3 June 2016.
CFCs (Action 3)	Hong Kong has a source-based taxation system and does not tax dividend income, so no specific rules in relation to Action 3 are expected.	N/A
Interest deductions (Action 4)	Although Hong Kong already has specific anti-avoidance provisions limiting the deductibility of certain interest expense, it does not have group ratio, fixed ratio or thin capitalization rules.	N/A
Harmful tax practices (Action 5)	The IRD will review and amend provisions found to be harmful, and consider the mandatory spontaneous exchange of information on certain rulings.	Consultation Paper was published on 26 Oct 2016. No relevant amendment bill has been introduced.
Prevent treaty abuse (Action 6)	The tax authorities require a Hong Kong resident to submit an application for a certificate of residence and have indicated that they may consider whether the applicant would be entitled to benefits under a tax treaty before issuing the certificate. In the Consultation Paper, the government plans to incorporate a "principal	Consultation Paper was published on 26 Oct 2016. Plan to change future DTAs and issue a DIPN.

Actions	*Notes on Implementation*	*Expected Timing*
	purposes test" in future Double Taxation Agreements (DTAs) and a symmetrical approach if a DTA partner has a different approach.	
Permanent establishment status (Action 7)	The IRD will amend the legislation and issue a DIPN to provide more guidelines.	Not yet known
Transfer pricing (Action 8-10)	Hong Kong currently has two DIPNs that provide guidance on transfer pricing and these generally follow the OECD guidelines. The IRD has placed transfer pricing as a high priority amongst the 15 BEPS actions. The key proposals of Actions 8-10 will be focused on the alignment of profits with economic activities.	Consultation Paper was published on 26 Oct 2016. No relevant amendment bill has been introduced.
Methodologies to collect and analyze data on BEPS (Action 11)	The measures to be taken under CbC reporting (Action 13) shall complement the economic analysis of BEPS.	N/A
Disclosure of aggressive tax planning (Action 12)	The Inland Revenue (Amendment) (No. 3) Ordinance 2016 was gazetted on 30 June 2016, to implement the new international standard on the Automatic Exchange of Information.	The legislation came into effect on 30 June 2016, with the first automatic information exchange to commence by the end of 2018.
Transfer pricing documentation (Action 13)	Transfer pricing is a high priority amongst the 15 BEPS actions. The IRD is reviewing the need to update current practices, including the revised documentation approach recommended by the G20 and OECD. The Consultation Paper proposed that the IRD would require multinationals to provide high level	Consultation Paper was published on 26 Oct 2016. No relevant amendment bill has been introduced.

Actions	*Notes on Implementation*	*Expected Timing*
	information on their global business operations and transfer pricing policies, transactional transfer pricing documentation specific to each country and annual CbC reports for each jurisdiction in which they do business. The Paper also introduced the three-tier transfer pricing documentation requirements as recommended in BEPS Action 13 (i.e. CbC report, master file and local file).	
CbC reporting (Action 13)	Hong Kong will implement CbC reporting for the accounting periods commencing on or after 1 January 2018, subject to necessary legislative amendments. As a transitional arrangement, parent surrogate filing will be made available for the accounting periods commencing between 1 January 2016 and 31 December 2017	Consultation Paper was published on 26 Oct 2016. No relevant amendment bill has been introduced.
Dispute resolution (Action 14)	The IRD considers improvements in cross-border tax dispute resolutions as a high priority.	Consultation Paper was published on 26 Oct 2016. No relevant amendment bill has been introduced.
Develop a multilateral instrument (Action 15)	Hong Kong plans to sign an OECD-coordinated multilateral instrument and all existing CDTAs will be amended to implement tax treaty-related BEPS measures.	Not yet known.

With the commitment to international tax cooperation, a consultation on measures to counter BEPS was launched on 26 October 2016 and ended on 31 December 2016. The Consultation Paper aims to introduce measures to meet the four minimum standards of BEPS Action Plan Project. The Government targets at introducing amendment bills to revise existing tax laws in late 2017. Main features of the Paper include:

1. A formalised transfer pricing regime: Advance pricing agreement ("APA") and a three-tiered transfer pricing documentation requirement are introduced.
2. Tax rulings: exchange of information on tax rulings are proposed to counter harmful tax practices.
3. Mutual agreement procedure ("MAP"): MAP acts as a cross-border dispute resolution mechanism in the Inland Revenue Ordinance
4. Multilateral instrument ("MLI"): MLI and relevant modifications are to be facilitated by necessary legislation.

Country-by-Country Reporting under Action 13 will be implemented in Hong Kong for the accounting periods commencing on or after 1 January 2018. The parent entity of multinational enterprise group will be required to file CbC reports within 12 months after the end of each accounting period. As a transitional arrangement, parent surrogate filing will be made available for the accounting periods commencing between 1 January 2016 and 31 December 2017.

Further to the consultation, the government has released the consultation report on 31 July 2017 and an amendment bill will be introduced by the end of 2017.

RELIEF FOR INTERNATIONAL SHIPPING AND AIRCRAFT INCOME

¶14-3000 Shipping income — tax relief arrangements with various countries

Hong Kong has entered into agreements with various countries in respect of shipping income. These provisions have been specified as arrangements for relief from double taxation and exchange of information for the purposes of s 49 of the *Inland Revenue Ordinance*. Under the agreement with the United States, gross income derived from international operation of ships by taxpayers who are residents of Hong Kong (other than United States citizens) is exempt from income tax in the United States, and vice versa. Under the agreements with other countries, income or profits derived from the operation of ships in international traffic by an enterprise of one country is taxable only in that country. The exemption applies to profits tax in Hong

Kong for all agreements and also extends to salaries tax under some agreements such as those with The Netherlands, Singapore and Sri Lanka.

The arrangements were respectively declared effective in the following:

- *Double Taxation Relief (Income from Shipping Operations) (United States of America) Order*;
- *Specification of Arrangements (Government of the United Kingdom of Great Britain and Northern Ireland) (Avoidance of Double Taxation on Shipping Income) Order*;
- *Specification of Arrangements (Government of the Kingdom of the Netherlands) (Avoidance of Double Taxation on Shipping Income) Order*;
- *Specification of Arrangements (Government of the Kingdom of Norway) (Avoidance of Double Taxation on Income from Shipping Operation) Order*;
- *Specification of Arrangements (Government of the Federal Republic of Germany) (Avoidance of Double Taxation on Shipping Income) Order*;
- *Specification of Arrangements (Government of the Republic of Singapore) (Avoidance of Double Taxation on Income from Shipping or Aircraft Operations) Order*;
- *Specification of Arrangements (Government of the Democratic Socialist Republic of Sri Lanka) (Avoidance of Double Taxation on Income from Shipping and Air Transport) Order*; and
- *Specification of Arrangements (Government of the Kingdom of Denmark) (Avoidance of Double Taxation on Income from Shipping Operation) Order*.

The relief from income tax of these contracting countries given under the agreements is only available to residents of Hong Kong who are not at the same time residents of these contracting countries. In the case of corporations, those which are controlled and managed in Hong Kong, and are not incorporated or managed in these contracting countries, are eligible for relief.

For relief from United States income tax, a corporation must also meet one of the following requirements in order to qualify:

- the corporation's stock must be primarily and regularly traded on a securities market in either Hong Kong, another country to which an equivalent exemption applies, or the United States; or
- more than 50% of its stock must be owned by: individuals resident in either Hong Kong or another country which grants a similar exemption; a corporation organised in a country which grants a similar exemption to United States corporations; another country which grants an equivalent exemption to United States corporations; or the United States (cl 2 of Agreement).

International shipping income

The income to which the exemption applies is specified under each agreement and varies from one agreement to another. Generally, all income derived from the international operation of ships are included, such as:

- income from the rental of ships used in international transport on a full- (time or voyage) or bare-boat basis;
- income from the rental of containers and related equipment used in international transport which is incidental to income from the international operation of ships;
- income from the participation in marine transport pools which engage in international operation of ships; and
- gains from the sale, disposal or other alienation of ships by a person primarily engaged in international operation, lease or rental of ships.

For the agreements with the Netherlands, Germany, Singapore, Sri Lanka and Denmark, interest income on funds directly connected with that operation is also included. For that of the Netherlands, remuneration of an employment exercised aboard a ship operated in international traffic is further included (when documentary evidence is produced that tax has been paid in the other contracting country).

¶14-3500 Aircraft income — tax relief arrangements with various countries

Hong Kong has entered into air services agreements with several countries. A number of these agreements include specific provisions to prevent double taxation of international air traffic income. These provisions have been specified as arrangements for relief from double taxation and exchange of information for the purposes of s 49 of the *Inland Revenue Ordinance*.

Under the double taxation arrangements, income or profits, which are derived from the operation of aircraft in international traffic by an airline of one country, and which are subject to tax in that country, are exempt from income tax, profits tax and all other taxes on revenues, receipts, income or profits in the other country on a reciprocal basis.

The exemption generally applies to income, profits, revenues or gross receipts derived from the operation of aircraft for the carriage of persons, livestock, goods, mail or merchandise. Income from ticket sales, or from the provision of services connected with the carriage of persons, livestock, goods, etc, are also included.

The double taxation arrangements may also provide the following reciprocal exemptions:

- capital and assets of an airline of one country are exempt from taxes imposed by the other country on a reciprocal basis;
- gains from the alienation of aircraft operated in international traffic and movable property pertaining to the operation of such aircraft which are received by an airline of one country are exempt from tax in the other country;
- the operation of aircraft in international traffic carried on by an airline of one country is exempt from value added tax and any similar tax imposed by the other country on a reciprocal basis; and
- property of a designated airline of one country relating to the operation of aircraft in the area of the other country is exempt from all taxes by the other country.

For the purposes of the double tax arrangements, "international traffic" generally means transport or carriage by an aircraft operated by an airline of a contracting party where the aircraft is not operated solely between places in the area of the other contracting party.

The double tax arrangements are contained in:

- the *Specification of Arrangements (Government of Canada Concerning Air Services) (Double Taxation) Order*;
- the *Specification of Arrangements (Government of the Republic of Korea Concerning Air Services) (Double Taxation) Order*;
- the *Specification of Arrangements (Government of New Zealand Concerning Air Services) (Double Taxation) Order*;

- the *Specification of Arrangements (Government of the Kingdom of the Netherlands Concerning Air Services) (Double Taxation) Order*;
- the *Specification of Arrangements (Government of the Federal Republic of Germany Concerning Air Services) (Double Taxation) Order*;
- the *Specification of Arrangements (Government of the United Kingdom of Great Britain and Northern Ireland Concerning Air Services) (Double Taxation) Order*;
- the *Specification of Arrangements (Government of the State of Israel Concerning Air Services) (Double Taxation) Order*;
- the *Specification of Arrangements (Government of the Republic of Mauritius Concerning Air Services) (Double Taxation) Order*;
- the *Specification of Arrangements (Government of the Russian Federation Concerning Air Services) (Double Taxation) Order*;
- the *Specification of Arrangements (Government of the Kingdom of Norway Concerning Air Services) (Double Taxation) Order*;
- the *Specification of Arrangements (Government of the Kingdom of Denmark Concerning Air Services) (Double Taxation) Order*;
- the *Specification of Arrangements (Government of the Kingdom of Sweden Concerning Air Services) (Double Taxation) Order*;
- the *Specification of Arrangements (Government of the People's Republic of Bangladesh Concerning Air Services) (Double Taxation) Order*;
- the *Specification of Arrangements (Government of the Republic of Estonia Concerning Air Services) (Double Taxation) Order*;
- the *Specification of Arrangements (Government of the Republic of Croatia Concerning Air Services) (Avoidance of Double Taxation) Order*;
- the *Specification of Arrangements (Government of the Macao Special Administrative Region) (Avoidance of Double Taxation on Income from Aircraft Operation) Order*;
- the *Specification of Arrangements (Government of the Republic of Singapore) (Avoidance of Double Taxation on Income from Shipping or Aircraft Operations) Order*;
- the *Specification of Arrangements (Government of the Democratic Socialist Republic of Sri Lanka) (Avoidance of Double Taxation on Income from Shipping and Air Transport) Order*;

- the *Specification of Arrangements (Government of Hashemite Kingdom of Jordan) (Avoidance of Double Taxation on Income from Aircraft Operation) Order*;
- the *Specification of Arrangements (Government of the Republic of Iceland) (Avoidance of Double Taxation on Income from Aircraft Operation) Order*;
- the *Specification of Arrangements (Government of the Republic of Kenya) (Avoidance of Double Taxation on Income from Aircraft Operation) Order*;
- the *Specification of Arrangements (Government of the State of Kuwait) (Avoidance of Double Taxation on Income from Aircraft Operation) Order*;
- the *Specification of Arrangements (Swiss Federal Council) (Avoidance of Double Taxation on Income from Aircraft Operation) Order*;
- the *Inland Revenue (Double Taxation Relief on Income from Aircraft Operations) (United Mexican States) Order*;
- the *Inland Revenue (Double Taxation Relief on Income from Aircraft Operations) (Republic of Finland) Order*;
- the *Inland Revenue (Double Taxation Relief on Income from Aircraft Operations) (Federal Democratic Republic of Ethiopia) Order*;
- the *Inland Revenue (Double Taxation Relief on Income from Aircraft Operations) (Republic of Maldives) Order*;
- the *Inland Revenue (Double Taxation Relief on Income from Aircraft Operations) (The Lao People's Democratic Republic) Order*;
- the *Inland Revenue (Double Taxation Relief on Income from Aircraft Operations) (Republic of Seychelles) Order*; and
- the *Inland Revenue (Double Taxation Relief on Income from Aircraft Operations) (The Republic of the Fiji Islands) Order*.

Preventing Hong Kong residents from escaping tax

The *Inland Revenue Ordinance* contains provisions to prevent Hong Kong resident aircraft owners from escaping tax completely.

It is specifically provided under the Ordinance that income from international air traffic earned by Hong Kong aircraft owners in territories outside Hong Kong with whom Hong Kong has concluded air service agreements ("arrangement territories") will be taxable in Hong Kong if it is not taxable in the territory in which it is earned (s 23C(2A)–(2D); see further ¶6-7980).