

**Subcommittee on
Two Orders Made under Section 49(1A) of the
Inland Revenue Ordinance and Gazetted on 4 October 2019**

Government's Responses to Written Submissions

Two orders were made under section 49(1A) of the Inland Revenue Ordinance (Cap. 112) (“IRO”) and gazetted on 4 October 2019 to give effect to the Comprehensive Avoidance of Double Taxation Agreement with Cambodia (“Cambodia CDTA”) and the Fifth Protocol to the Comprehensive Avoidance of Double Taxation Arrangement with the Mainland (“Mainland Fifth Protocol”) respectively. This note sets out the Government’s responses to the relevant issues raised by a member of the public.

General response

2. It has been the Government’s policy to enter into comprehensive avoidance of double taxation agreements/arrangements (“CDTAs”) with trading and investment partners of Hong Kong so as to minimise double taxation and promote bilateral trade and investment with the treaty partners. The Cambodia CDTA will help foster closer economic ties with Cambodia, and help investors better assess their potential tax liabilities from cross-border economic activities.

3. As for the Mainland Fifth Protocol, it incorporates into the Comprehensive Avoidance of Double Taxation Arrangement with the Mainland (“Mainland CDTA”) a tax relief measure for eligible Hong Kong and Mainland teachers and researchers working on the other side, as well as measures to prevent tax treaty abuse so that the Mainland CDTA follows the latest international tax standard.

4. We therefore consider it essential to give effect to the Cambodia CDTA and the Mainland Fifth Protocol so that the double taxation relief therein can benefit Hong Kong residents as soon as possible.

5. Our responses to the specific issues raised by the member of the public are set out in the ensuing paragraphs.

Article 23 of the Cambodia CDTA

6. Article 23 of the Cambodia CDTA (i.e. Methods for Elimination of Double Taxation Article) provides relief for double taxation where the same income is taxable in the hands of the same person by both Hong Kong and Cambodia. Paragraphs 1 and 2 of Article 23 are respectively applicable to Cambodian residents and Hong Kong residents only. Paragraph 3 of Article 23, which applies to residents of both sides, contains tax sparing provisions which allow residents of one side to obtain a foreign tax credit for the taxes that have been “spared” (i.e. taxes that have not been actually paid) under the tax incentive programme of the other side. A sunset clause is included in paragraph 3 to limit the application of the tax sparing provision to ten years starting from the entry into force of the Cambodia CDTA, subject to further extension by mutual agreement of the competent authorities of Hong Kong and Cambodia. It is a general provision and does not refer to any particular economic development project.

7. Pursuant to paragraphs 2 and 3 of Article 23, if a Hong Kong resident invests in Cambodia and derives income therefrom, the amount of tax which Cambodia could have imposed on that income in accordance with its general legislation shall be allowed as a credit against Hong Kong tax payable in respect of that income, even if Cambodia has waived all or part of tax under its specific legislation for promoting its economic development. The tax sparing provision has no connection with the Cambodia Democracy Act of 2019 of the United States.

8. It is not unusual to include a tax sparing provision in a CDTA between a developed economy and a developing economy where the latter may grant tax incentives to attract foreign investment. Similar provisions also exist in our CDTAs with Brunei, Malaysia, Thailand and Vietnam.

Article 18A of the Mainland CDTA

9. The Mainland Fifth Protocol incorporates a new Article 18A (i.e. Teachers and Researchers Article, or “Teachers Article”) into the Mainland CDTA.

10. Under the Teachers Article, if an individual employed by a recognised educational or scientific research institution of one side (residence side) visits the other side (work side) and stays there for the primary purpose of teaching or conducting research at a recognised educational or scientific research institution of the work side, his/her remuneration for such teaching or research to the extent that it is paid by or on behalf of his/her employer in the residence side shall be exempt from tax in the work side for a period not exceeding three years, provided that such remuneration is subject to tax in the residence side and (in relation to remuneration for research) the research is undertaken in the public interest. The Teachers Article puts in place a reciprocal arrangement that applies to both Hong Kong and the Mainland, and only provides tax relief to reduce the tax burden of eligible teachers and researchers who work in the other side. Such tax relief measure aims at promoting academic exchange and co-operation in research and development between the Mainland and Hong Kong. It does not relate to any labour importation scheme.

11. The scope of the Teachers Article and details of the Mainland Fifth Protocol were set out in a press release issued by the Government on 19 July 2019¹. The Inland Revenue Department will provide further guidance on the application of the Teachers Article in due course.

Reaching Agreements by Competent Authorities

12. When administering CDTAs, it is quite common for the competent authorities of the contracting parties to seek to resolve their differences on the interpretation and application of the CDTA provisions by mutual agreement. Various articles of Hong Kong's CDTAs contain provisions to such effect and were formulated with reference to the Model Tax Convention on Income and on Capital promulgated by the Organisation for Economic Co-operation and Development ("OECD").

13. As for the mutual agreement procedure ("MAP") referred to in the submissions, it is part of the dispute resolution mechanism under CDTAs and may be initiated by a taxpayer who considers that actions of the competent authority of one or both of the jurisdictions concerned have resulted or will

¹ The press release is available at <https://www.info.gov.hk/gia/general/201907/19/P2019071900850.htm>.

result in taxation not in accordance with the provisions of a CDTA. The MAP requires the competent authorities concerned to communicate with each other directly with a view to resolving disputes regarding the application of the CDTA, and it is not a must to go through mediation or arbitration. Both the Cambodia CDTA and the Mainland CDTA do not contain any mandatory mediation or arbitration provision.

14. The MAP provides taxpayers with an avenue for review in addition to the rights of objections and appeals under Part 11 of the IRO. The Commissioner of Inland Revenue will consider concurrently a case presented to him under MAP and an objection lodged by the taxpayer under the IRO.

15. Regarding the Double Taxation Dispute Resolution (EU) Regulations 2019 (Draft) of the United Kingdom (“the Regulations”) mentioned in one of the submissions, we understand that the Regulations are for implementing a Council Directive of the European Union (“EU”) on tax dispute resolution mechanisms in the EU. The EU Directive and the Regulations are not applicable to Hong Kong.

Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (“Multilateral Instrument”)

16. Regarding the Multilateral Instrument mentioned in the submissions, we do not consider it relevant to the Cambodia CDTA and the Mainland Fifth Protocol. However, in view of the comments raised, we give an update below on the progress of implementing the Multilateral Instrument in Hong Kong.

17. The OECD released a package of 15 actions in October 2015 to counter the base erosion and profit shifting (“BEPS”) strategies of multinational enterprises (“MNEs”)², with the development of the Multilateral Instrument one of the actions under the BEPS package. The Multilateral Instrument seeks to ensure swift, coordinated and consistent implementation of tax treaty-related BEPS measures in a multilateral context by obviating the need for individual jurisdictions to conduct cumbersome negotiations to amend their bilateral tax treaties to meet the OECD’s requirements.

² BEPS refers to tax avoidance strategies of MNEs which exploit the gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity as to minimise tax payments.

18. The Government conducted a public consultation exercise from October to December 2016 on the legislative proposals to implement the BEPS package³. A number of respondents supported our proposal to modify the application of Hong Kong's CDTAs by way of the Multilateral Instrument (as opposed to bilateral negotiations) as this would ensure consistency and provide greater certainty for taxpayers⁴. The Government subsequently decided to implement the treaty-related minimum standards of the BEPS package only (save for an optional provision relating to the preamble of CDTAs), while opting out of the remaining substantive articles. We briefed the Legislative Council ("LegCo") Panel on Financial Affairs in March 2018 on the implementation approach⁵, and Members had no adverse comment.

19. The Central People's Government ("CPG") has agreed to extend the application of the Multilateral Instrument to Hong Kong. After the CPG deposits with the OECD the final list of reservations and notifications applicable to Hong Kong under the Multilateral Instrument, we will seek the approval of the Chief Executive in Council for making an order under section 49 of the IRO to give effect to the Multilateral Instrument in Hong Kong. The order will be subject to negative vetting by the LegCo.

**Financial Services and the Treasury Bureau
Inland Revenue Department
October 2019**

³ The consultation paper is available at <https://www.fstb.gov.hk/tb/en/docs/BEPS-ConsultationPaper-e.pdf>.

⁴ The consultation report is available at <https://www.fstb.gov.hk/tb/en/docs/BEPS-ConsultationReport-e.pdf>.

⁵ The relevant paper discussed by the LegCo Panel on Financial Affairs is available at <https://www.legco.gov.hk/yr17-18/english/panels/fa/papers/fa20180305cb1-625-2-e.pdf>.