

財經事務及庫務局

香港添馬添美道二號  
政府總部二十四樓



LC Paper No. CB(1)43/19-20(05)

FINANCIAL SERVICES AND  
THE TREASURY BUREAU

24/F, Central Government Offices  
2 Tim Mei Avenue, Tamar  
Hong Kong

傳真號碼 Fax No. : (852) 2523 0642  
電話號碼 Tel. No. : (852) 2810 2229  
本函檔號 Our Ref. : TsyB R2 183/800-1-1/17/0 (C) & TsyB R2 183/800-1-1/65/0 (C)  
來函檔號 Your Ref. : LS/S/37/18-19

**By fax (2877 5029) & email (rktdai@legco.gov.hk)**

24 October 2019

Miss Rachel Dai  
Assistant Legal Adviser  
Legal Service Division  
Legislative Council Secretariat  
Legislative Council Complex  
1 Legislative Council Road  
Central, Hong Kong

Dear Miss Dai,

**Inland Revenue (Double Taxation Relief and Prevention of Fiscal Evasion  
with respect to Taxes on Income) (Kingdom of Cambodia) Order  
(L.N. 117 of 2019)**

**Specification of Arrangements (The Mainland of China) (Avoidance of  
Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes  
on Income) (Fifth Protocol) Order (L.N. 118 of 2019)**

Thank you for your letter dated 22 October 2019 on the captioned  
Orders. Our response is set out in the attached note.

Yours sincerely,

A handwritten signature in black ink, appearing to be 'Billy Lam', written over a white background.

( Billy Lam )

for Secretary for Financial Services and the Treasury

c.c.

Commissioner of Inland Revenue  
Department of Justice

(Attn: Mr K. K. Chiu)  
(Attn: Ms Carmen Chu)

**Inland Revenue (Double Taxation Relief and Prevention of Fiscal Evasion with respect to Taxes on Income) (Kingdom of Cambodia) Order (L.N. 117 of 2019)**

**Specification of Arrangements (The Mainland of China) (Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income) (Fifth Protocol) Order (L.N. 118 of 2019)**

**Government's Response**

**Part I: L.N. 117 of 2019**

*Question 1*

The Assistant Legal Adviser of the Legislative Council (“LegCo”) Secretariat refers to a paper submitted by the Government in 2009, which made reference to the then understanding that the exchange of information (“EoI”) article of Hong Kong’s comprehensive avoidance of double taxation agreements/arrangements (“CDTAs”) did not create obligations as regards automatic or spontaneous EoI between the contracting parties.

2. In recent years, the Organisation for Economic Co-operation and Development (“OECD”) promulgated new international standards on tax co-operation. Hong Kong has correspondingly implemented a number of initiatives to comply with these requirements, including automatic exchange of financial account information in tax matters (“AEOI”)<sup>1</sup> and combating base erosion and profit shifting (“BEPS”), which involves automatic exchange of country-by-country reports and spontaneous exchange of information on tax rulings<sup>2</sup>. With these new developments, the EoI article of CDTAs that Hong Kong signed in recent years no longer contains provisions which preclude automatic or spontaneous EoI. For example, the EoI article of our CDTAs signed with Belarus, Saudi Arabia, India and Finland in 2017 and 2018 duly reflected this change.

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<sup>1</sup> Please see paragraph 2 of the LegCo Brief on Inland Revenue (Amendment) Bill 2016 at [https://www.legco.gov.hk/yr15-16/english/bills/brief/b201601081\\_brf.pdf](https://www.legco.gov.hk/yr15-16/english/bills/brief/b201601081_brf.pdf).

<sup>2</sup> Please see paragraph 5 of the LegCo Brief on Inland Revenue (Amendment) (No. 5) Bill 2017 and Inland Revenue (Double Taxation Relief and Prevention of Fiscal Evasion with respect to Taxes on Income) (New Zealand) (Amendment) Order 2017 at [https://www.legco.gov.hk/yr17-18/english/bills/brief/b201710061\\_brf.pdf](https://www.legco.gov.hk/yr17-18/english/bills/brief/b201710061_brf.pdf).

3. We note that Cambodia has so far not set any date for implementing AEOI nor committed to the OECD to implement the BEPS package. Hence, while the EoI Article of the CDTA signed with Cambodia would not preclude the possibility of automatic or spontaneous EoI having regard to the Commentary on the Model Tax Convention on Income and on Capital (“Model Tax Convention”) promulgated by the OECD, there will be no automatic or spontaneous EoI between Hong Kong and Cambodia at this stage.

4. Regarding the scope of “judicial decisions” under the EoI Article, we confirm that it covers, in the case of Hong Kong, the decisions of the Board of Review, whether or not this is explicitly provided in a CDTA or not.

#### *Question 2*

5. We confirm that the government bodies of Cambodia with a supervisory function over tax administration and enforcement as set out in paragraph 2 of the Protocol to the CDTA with Cambodia are meant to be exhaustive.

## **Part II: L.N. 118 of 2019**

### General

#### *Question 3*

6. A marked-up version of the relevant provisions showing the changes specified in the Fifth Protocol to the CDTA with the Mainland (“Mainland Fifth Protocol”) made to the CDTA with the Mainland and its four related Protocols (“Mainland CDTA”) is at **Annex**.

#### *Question 4*

7. The OECD released a package of 15 actions in October 2015 to counter BEPS by multinational enterprises (“MNEs”). Some actions of the BEPS package seek to address gaps in the bilateral tax treaty system that have been exploited by the MNEs. These include **Action 6** (which seeks to prevent the granting of treaty benefits in inappropriate circumstances)<sup>3</sup> and **Action 7** (which seeks to prevent artificial avoidance of permanent establishment (“PE”) status to counter BEPS)<sup>4</sup>.

8. The Mainland Fifth Protocol seeks to ensure that the Mainland CDTA which was first signed in 2006 follows the latest international tax standards as mentioned above. More specifically –

(a) **Article 1** amends the preamble of the Mainland CDTA to include an express statement that the common intention of the Mainland and Hong Kong is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements); and to refer to a desire to further develop their economic relationship and to enhance cooperation in tax matters (**Action 6** of the BEPS package refers);

(b) **Article 2** modifies the rule in Article 4 of the Mainland CDTA (i.e. Resident Article) for determining residence in cases of dual residence of a person other than an individual to provide that the competent authorities of the Mainland and Hong Kong shall endeavour to determine by mutual agreement the side of which such person shall be deemed to be a resident for the purposes of the Mainland CDTA (**Action 6** of the BEPS package refers);

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<sup>3</sup> The OECD’s report on Action 6 is available at <https://www.oecd.org/tax/beps/preventing-the-granting-of-treaty-benefits-in-inappropriate-circumstances-action-6-2015-final-report-9789264241695-en.htm>.

<sup>4</sup> The OECD’s report on Action 7 is available at <https://www.oecd.org/tax/beps/preventing-the-artificial-avoidance-of-permanent-establishment-status-action-7-2015-final-report-9789264241220-en.htm>.

- (c) **Article 3** amends Article 5 of the Mainland CDTA (i.e. PE Article) to address the artificial avoidance of PE status through commissionaire arrangements and similar strategies. The new provisions amend the conditions of the existing provisions under which an enterprise of one side is deemed to have a PE in the other side in respect of any activities which a person other than an independent agent undertakes for the enterprise (**Action 7** of the BEPS package refers);
- (d) **Article 4** modifies the scope of Article 13 of the Mainland CDTA (i.e. Capital Gains Article) which deals with the taxation of capital gains from the alienation of shares deriving their value principally from immovable property to cover taxation of capital gains from the alienation of shares and comparable interests, such as interests in a partnership or trust, deriving more than 50% of their value directly or indirectly from immovable property at any time during the three years preceding the alienation (**Action 6** of the BEPS package refers); and
- (e) **Article 6** amends the anti-abuse rule in the Mainland CDTA to provide that a benefit under the Mainland CDTA shall not be granted if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Mainland CDTA. The revised anti-abuse rule takes the form of the principal purpose test to address treaty shopping, as required by **Action 6** of the BEPS package.

9. The above articles follow the relevant provisions of the updated version of the Model Tax Convention promulgated by the OECD in 2017 (“2017 Model Tax Convention”).

## Article 2

### *Question 5*

10. Regarding the mutual agreement process for determining the resident status of a person other than an individual as envisaged under the amended paragraph 3 of the Resident Article of the Mainland CDTA, a taxpayer (the Subject Person) which considers that actions of the competent authority of one or both of the jurisdictions have resulted or will result in taxation not in accordance with the provisions of the Mainland CDTA may initiate such process. The Subject Person may provide the competent authorities with documents to support its case and, if necessary, may provide further information at the request of the competent authorities. The competent authorities may also make use of the information provided by the Subject Person in other contexts (e.g. information in tax returns) to facilitate the processing of the case. All information relevant to the case will be taken into account in the negotiations between the two competent authorities, and the Subject Person will be kept informed of the progress.

11. If the competent authorities of both sides are unable to reach an agreement, the Subject Person will be informed of the reasons and it may continue to seek remedy under the Inland Revenue Ordinance (Cap. 112) (“IRO”) or the relevant Mainland laws if applicable.

## Article 3

### *Question 6*

12. The amended paragraph 5 of the PE Article of the Mainland CDTA treats an enterprise of one side (the enterprise) as having a PE in the other side in respect of certain activities that a person other than an independent agent (the person) undertakes for the enterprise. This paragraph seeks to cover cases where the activities that the person exercises are intended to result in the regular conclusion of contracts to be performed by the enterprise.

13. Article 3 of the Mainland Fifth Protocol amends paragraph 5 of the PE Article of the Mainland CDTA in order to prevent the use of tax avoidance strategies to circumvent the existing provisions which rely on the formal conclusion of contracts in the name of the enterprise. Specifically, the wording of subparagraphs (1), (2) and (3) of the amended paragraph 5 ensures that the paragraph applies not only to contracts that create rights and obligations that are legally enforceable between the enterprise and the third parties with which these contracts are concluded (i.e. situation under subparagraph (1)), but also to contracts that create obligations that will effectively be performed by the enterprise rather than by the person contractually obliged to do so (i.e. situations under subparagraphs (2) or (3)). As such, with regard to the contracts habitually concluded by a person on behalf of an enterprise “for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use” or “for the provision of services by that enterprise” as referred to in paragraph 5(2) and (3) of the amended PE Article, they do not necessarily have to be concluded in the name of the enterprise.

#### *Question 7*

14. The last sentence of paragraph 6 of the PE Article of the Mainland CDTA as amended by the Mainland Fifth Protocol specifies a rule where a person acting on behalf of closely related enterprises shall not be considered to be an independent agent. With reference to the commentary on Article 5 of the 2017 Model Tax Convention promulgated by the OECD, the phrase “almost exclusively on behalf of one or more enterprises to which that person is closely related” means that a significant part of the person’s business is conducted as an agent acting for one or more closely related enterprises. For example, the total sales of Company A are HK\$100. Company A will be treated as acting “almost exclusively” on behalf of the closely related enterprises when more than 90% of its total sales (i.e. more than HK\$90) are derived from the sales that Company A concludes as an agent for such closely related enterprises.

## Article 5

### *Question 8*

15. The terms “university”, “college”, “school”, “educational institution or scientific research institution recognised by the Government” are not defined in the Mainland CDTA. Pursuant to paragraph 3 of Article 3 (i.e. General Definitions Article) of the Mainland CDTA, unless the context otherwise requires, undefined terms should have the meaning which they have under the laws of the side applying the Mainland CDTA, and any meaning under the applicable tax laws of that side prevails over a meaning given to the terms under other laws of that side.

16. In the case of the Mainland, reference has to be made to two circulars promulgated by the State Taxation Administration (“STA”) which set out the scope of institutions to which the Teachers and Researchers Article in CDTAs (including the new Article 18A of the Mainland CDTA) applies –

- (a) pursuant to STA Circular [2016] No. 91<sup>5</sup>, “university, college, school or educational institution recognised by the Government” means schools providing pre-primary, primary, secondary, higher and special education, including kindergartens, primary schools, primary schools for adults, junior high schools, vocational junior high schools, senior high schools, senior high schools for adults, specialised secondary schools, specialised secondary schools for adults, vocational high schools, technical schools, special education schools, schools for children of foreign personnel, colleges and universities, higher vocational (professional) colleges and adult education colleges; and
- (b) pursuant to STA Circular [1999] No. 37<sup>6</sup>, “scientific research institution recognised by the Government” means

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<sup>5</sup> STA Circular [2016] No. 91 (in Chinese only) is available at <http://www.chinatax.gov.cn/n810341/n810755/c2435657/content.html>.

<sup>6</sup> STA Circular [1999] No. 37 (in Chinese only) is available at <http://www.chinatax.gov.cn/chinatax/n810346/n810825/c101434/c4163/content.html>.



institutions that are under the administration of ministries/committees/institutes of the State Council, provinces, autonomous regions, municipalities as well as cities specially designated in the state plan; and are exclusively engaged in scientific research and development.

17. In the case of Hong Kong, “university”, “college”, “school”, “educational institution or scientific research institution recognised by the Government” refer to those recognised under the IRO or other relevant legislation in Hong Kong (e.g. the Education Ordinance (Cap. 279) and various ordinances governing the universities, etc.).

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