

立法會
Legislative Council

LC Paper No. CB(1)1057/15-16

Ref: CB1/SS/9/15

Paper for the House Committee meeting on 24 June 2016

**Report of the Subcommittee on the Two Orders Made under Section 49(1A) of
the Inland Revenue Ordinance and Gazetted on 13 May 2016**

Purpose

This paper reports on the deliberations of the Subcommittee on the Two Orders Made under Section 49(1A) of the Inland Revenue Ordinance and Gazetted on 13 May 2016 ("the Subcommittee").

Background

2. Double taxation refers to the imposition of comparable taxes in more than one tax jurisdiction in respect of the same source of income. The international community generally recognizes that double taxation hinders the exchange of goods and services, movements of capital, technology and human resources, and poses an obstacle to the development of economic relations between economies. As a business facilitation initiative, it is the Government's policy to enter into Comprehensive Agreements for Avoidance of Double Taxation ("CDTAs") with Hong Kong's trading and investment partners.

3. Hong Kong adopts the territorial concept of taxation whereby only income sourced from Hong Kong is subject to tax. A local resident's income derived from sources outside Hong Kong will not be taxed in Hong Kong and hence will not be subject to double taxation. Double taxation may occur where a foreign jurisdiction taxes its own residents' income derived from Hong Kong. Although many jurisdictions do provide their residents with unilateral tax relief for the Hong Kong tax they paid on the income derived therefrom, the existence of a CDTA will provide enhanced certainty and stability in respect of the elimination of double taxation. Besides, the tax relief provided under a CDTA may exceed the level provided unilaterally by a tax jurisdiction.

The two Orders

4. The two Orders are made by the Chief Executive in Council under section 49(1A) of the Inland Revenue Ordinance (Cap. 112) ("the Ordinance") to give effect to the respective CDTAs. Details of the Orders and CDTAs are provided as follows:

- (a) L.N. 61 of 2016 – Inland Revenue (Double Taxation Relief and Prevention of Fiscal Evasion with respect to Taxes on Income) (Romania) Order – to give effect to the CDTA between the Government of the Hong Kong Special Administrative Region of the People's Republic of China ("HKSARG") and the Government of Romania and signed on 18 November 2015 ("the Romanian Agreement"); and
- (b) L.N. 62 of 2016 – Inland Revenue (Double Taxation Relief and Prevention of Fiscal Evasion with respect to Taxes on Income) (Russian Federation) Order – to give effect to the CDTA between HKSARG and the Government of the Russian Federation and signed on 18 January 2016 ("the Russian Agreement").

The two Orders will come into operation on 29 July 2016.

The Subcommittee

5. At the House Committee ("HC") meeting on 20 May 2016, Members agreed to form a subcommittee to study the two Orders. The membership list of the Subcommittee is in **Appendix**. Under the chairmanship of Hon Kenneth LEUNG, the Subcommittee held one meeting on 31 May 2016 with the Administration to examine the two Orders.

6. To allow sufficient time for the Subcommittee to compile a report to HC, the Subcommittee agreed to move a proposed resolution at the Council meeting of 8 June 2016 to extend the period for amending the two Orders to 6 July 2016. As the proposed resolution was not dealt with at the Council meeting of 15 June 2016 (i.e. the last Council meeting at which a proposed resolution may be moved to extend the scrutiny period for the two Orders), the scrutiny period of the two Orders has expired after the Council meeting of 15 June 2016.

Deliberations of the Subcommittee

7. The Subcommittee supports the two Orders. The major views and deliberations of the Subcommittee and the Administration's responses are set out in

the ensuing paragraphs.

Benefits of the Romanian Agreement and the Russian Agreement

8. The Subcommittee has examined the benefits of the Romanian Agreement and the Russian Agreement. Members note that in the absence of the two Agreements, income earned by Romanian or Russian residents in Hong Kong is subject to both Hong Kong tax and Romanian or Russian tax (as the case may be). Moreover, profits of Hong Kong companies doing business through a permanent establishment in Romania or Russia may be taxed in both Hong Kong and Romania or Russia if the income is Hong Kong sourced. Under the two Agreements, tax paid in Hong Kong will be allowed as a deduction or credit against tax payable in Romania or Russia in respect of the income. Double taxation will also be avoided in that any Romanian tax or Russian tax paid by Hong Kong companies in such case will be allowed as a credit against the tax payable in Hong Kong in respect of the income, subject to the provisions of the tax laws of Hong Kong.

9. Members further note that income derived by a Hong Kong resident, which is not paid by (or on behalf of) and borne by a Romanian or Russian entity, from employment exercised in Romania or Russia will be exempted from Romanian or Russian tax if his or her aggregate stay in Romania or Russia in any relevant 12-month period does not exceed 183 days. Moreover, profits from international shipping transport earned by Hong Kong residents and arising in Romania or Russia, which are currently subject to tax in these two places, will not be taxed in Romania and Russia under the respective Agreements.

10. The Administration has advised that the two Agreements have already set out the allocation of taxing rights between jurisdictions and the relief on tax rates on different types of income. The Subcommittee notes that on the Romanian withholding tax, the current rate is 16% both on royalties and dividends. Under the Romanian Agreement, the withholding tax rate on royalties will be capped at 3%. As for dividends, it will be capped at 3% if the beneficial owner is a company which holds directly at least 15% of the capital of the company paying the dividends, and capped at 5% in all other cases. As regards the Russian withholding tax, the Subcommittee notes that for royalties, the current rates are 20% for companies and 30% for individuals; and for dividends, the current rate is 15%. Under the Russian Agreement, the withholding tax rate on royalties will be capped at 3%. As for dividends, it will be capped at 5% if the beneficial owner is a company which holds directly at least 15% of the capital of the company paying the dividends, and capped at 10% in all other cases.

11. Some members have enquired about the proposed cap of 3% on royalties under the Russian Agreement. The Administration has explained that under the Russian Agreement, the right to tax the royalty income is a shared taxing right, i.e.

both tax jurisdictions are given the right to tax royalty income. The resident jurisdiction is required to give double taxation relief to its residents for the income doubly assessed (i.e. the source jurisdiction has the primary right to tax and the resident jurisdiction is left with a secondary right). The source jurisdiction's right to tax royalty income is subject to a limit of 3% on the gross amount of the royalties, if the beneficial owner of the royalties is a resident of the resident jurisdiction.

12. On members' enquiry about the tax relief in terms of withholding tax rates on interests in the Romanian Agreement and the Russian Agreement, the Administration has advised that under the Romanian Agreement, both tax jurisdictions are given the right to tax interest income. As agreed under the Romanian Agreement, the source jurisdiction's tax rate on interest income is subject to a limit of 0% if Hong Kong levies no withholding tax on the interest. Otherwise, the rate will be capped at 3%. This effectively means that the tax rates on interest income will be 0% since Hong Kong levies no withholding tax on interest income. The Administration has further advised that under the Russian Agreement, the right to tax interest income is allocated exclusively to the resident jurisdiction.

13. The Administration has added that the relief on tax rates on different types of income will help investors to better assess their potential tax liabilities from cross-border economic activities, foster closer economic and trade links, and provide added incentives for enterprises of Romania and Russia to do business or invest in Hong Kong, and vice versa.

Exchange of information provisions in the Romanian Agreement and the Russian Agreement

14. The Subcommittee has examined whether the two Agreements have incorporated sufficient safeguards to protect taxpayers' privacy and confidentiality of information exchanged under the exchange of information ("EoI") arrangement. As explained by the Administration, a CDTA normally includes an article that provides for EoI. Hong Kong adopts the 2004 version of the EoI Article in the Organization for Economic Cooperation and Development Model Tax Convention on Income and on Capital ("OECD Model Tax Convention") except for certain modifications which are allowable under the OECD standard to address local needs. The Inland Revenue (Amendment) (No. 2) Ordinance 2013 which came into effect in July 2013, amongst others, has further enhanced the EoI arrangement under CDTAs in terms of tax types and limitation on disclosure. The Administration has pointed out that the Romanian Agreement and the Russian Agreement have adopted highly prudent safeguard measures to protect taxpayers' privacy and confidentiality of any information exchanged which include the following:

- (a) information will only be exchanged upon receipt of request and no information will be exchanged on an automatic or spontaneous basis;

- (b) the information sought should be foreseeably relevant, i.e. there will be no fishing expedition;
- (c) information received by CDTA partners should be treated as confidential;
- (d) information will only be disclosed to the tax authorities and not for release to their oversight bodies unless there are legitimate reasons given by the CDTA partners;
- (e) information requested should not be disclosed to a third jurisdiction; and
- (f) there is no obligation to supply information under certain circumstances, for example, where the information would disclose any trade, business, industrial, commercial or professional secret or trade process, or which would be covered by legal professional privilege, etc.

15. Members also note that regarding the scope of tax types for the purpose of EoI, the Administration has adopted a positive listing approach, in that the two Agreements have set out the tax types, other than income taxes¹ or other taxes of a similar character. Such other tax types applicable to Romania are value-added tax and excise duties, whilst those applicable to Russia are value-added tax, tax on property of organizations and tax on property of individuals.

16. The Subcommittee notes the Legal Adviser's enquiry about the implication on the application of the EoI Article in the Romanian Agreement and the Russian Agreement if the Inland Revenue (Amendment) Bill 2016, which is related to the implementation of automatic exchange of financial information in tax matters ("AEOI") in Hong Kong, is enacted. The Administration has explained that the Inland Revenue (Amendment) Bill 2016 seeks to put in place a legal framework for the implementation of AEOI in Hong Kong. The Bill, if enacted, will not affect the application of the EoI Article in the Romanian Agreement and the Russian Agreement, because EoI will be conducted on a request basis under both agreements. If any AEOI is to be conducted between Hong Kong and its CDTA partners, separate competent authority agreements (in addition to the CDTA signed) will have to be entered into with the partners concerned, and a notice (which is subject to negative vetting by the Legislative Council) would be required to include the name of the partners concerned in the relevant schedule to be added to the Ordinance.

¹ Income taxes refer to those imposed on taxpayers (i.e. individuals or entities) that vary with the income or profits of the taxpayers, such as taxes on business profits, employment income, rental income, capital gains, interest, royalty, dividends and pensions.

Drafting issues

17. On members' enquiry about whether there is any deviation from the OECD Model Tax Convention in the articles of the Romanian Agreement and the Russian Agreement, the Administration has advised that the Romanian Agreement and the Russian Agreement generally adopt the articles in the OECD Model Tax Convention except for certain modifications to address the various concerns of the contracting parties respectively. The articles in the two Agreements are similar to those in the CDTAs signed between HKSARG and other jurisdictions previously. The differences may only be those specific references to the contracting party concerned, such as the scope of tax types covered by the CDTAs and the definitions of the contracting parties.

18. Noting that there have been territory disputes between Russia and China, the Subcommittee is concerned about the definition of the term "Russia" in the Russian Agreement, particularly in a geographical sense, and the application of the Agreement in the cases involving a resident or a company of a disputed territory. The Administration has assured the Subcommittee that due consideration is given to the definition of the country or territory involved during the negotiation of CDTAs with other jurisdictions, and the definition of the term "Russia" in the Russian Agreement is the same as that used in the CDTA signed between China and Russia.

19. Some members have enquired about the difference between Article 25 (Fiscal Privileges) of the Romanian Agreement and Article 26 (Members of Government Missions) of the Russian Agreement. The Administration has responded that the two articles adopted the Members of Diplomatic Missions and Consular Posts Article in the OECD Model Tax Convention. In accordance with the Basic Law, Hong Kong is a special administrative region of the People's Republic of China, and the reference to "diplomatic missions" and the text of the relevant articles should therefore be modified in the tax agreements signed between HKSARG and other jurisdictions. Article 25 of the Romanian Agreement follows the general format of the article used in the CDTAs signed by Hong Kong, though there are also cases where the reference to "consular posts" is also included, as in Article 26 of the Russian Agreement in response to Russia's request. The Administration has assured the Subcommittee that there is no material difference in the practical operation between the versions.

Advice sought

20. Members are invited to note the deliberations of the Subcommittee.

**Subcommittee on the Two Orders Made under Section 49(1A) of
the Inland Revenue Ordinance and Gazetted on 13 May 2016**

Membership List

Chairman	Hon Kenneth LEUNG
Members	Hon James TO Kun-sun Hon Alan LEONG Kah-kit, SC
	(Total : 3 members)
Clerk	Mr Desmond LAM
Legal Adviser	Miss Carrie WONG