

Press release

LCQ16: Arrangement for avoidance of double taxation

Wednesday, December 7, 2011

Following is a question by Dr Hon Lam Tai-fai and a written reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (December 7):

Question:

Regarding the reply given by the Secretary for Financial Services and the Treasury (SFST) to my written question on November 23 this year, will the Government inform this Council:

(a) given that SFST stated that the "days of physical presence" method was commonly adopted by various tax jurisdictions in determining the tax liabilities of a person, whether it knows if there are tax jurisdictions which do not use the "days of physical presence" method; if there are, of the methods they adopt and the reasons why Hong Kong has not adopted such methods;

(b) given that SFST stated that some European countries (the countries concerned) had special tax provisions for frontier workers, of the names of the countries concerned, as well as their time frame and reasons for implementing such provisions (list in table form);

(c) given that SFST stated that as Hong Kong's taxation system was based on the territorial principle, Hong Kong residents' income derived from the Mainland was not subject to tax in Hong Kong, and that the proposal of introducing special tax provisions for frontier workers would lead to double non-taxation of the income, whether it knows if the taxation systems of the countries concerned are based on the territorial principle; if they are, how these countries overcome the aforesaid problem; if not, of the principles on which the taxation systems of these countries are based;

(d) given that SFST stated that it was difficult to determine the coverage of the exemption area and to define frontier workers on an objective basis, whether it knows how the countries concerned determine the coverage of their exemption areas and define frontier workers (list in table form), and whether Hong Kong can adopt the practices of the countries concerned; if they can be adopted, of the details; if not, the reasons for that;

(e) given that SFST stated that the proposal of introducing special tax provisions for frontier workers required careful deliberations, when the outcome of the authorities' deliberations will be available, and whether consultation will be conducted on the proposal; if consultation will be conducted, who or what organisations will be consulted; if not, the reasons for that;

(f) given that SFST stated that if a part of a person's income had been assessed to Individual Income Tax on the Mainland, that part of the income could be exempted from Hong Kong salaries tax under section 8(1A)(c) of the Inland Revenue Ordinance (Cap. 112), of the number of taxpayers applying for such exemptions in each of the past five years, and the amount of tax exemptions involved;

(g) given that there were cases in which all the incomes of some Hong Kong residents were subject to mainland taxes on the ground that they were present on the Mainland for more than 183 days within a year, and their incomes were also subject to Hong Kong's salaries tax on a pro-rata basis as they had stayed in Hong Kong for more than 60 days within the same year of tax assessment, whether there is the situation of part of their incomes being subject to double taxation in these cases; if so, how the problem is to be solved; if not, of the reasons for that;

(h) given that some Hong Kong residents have reflected that although all their incomes are subject to salaries tax in Hong Kong, all their bonus incomes, according to the tax provisions on the Mainland, are subject to Individual Income Tax on the Mainland even though they do not stay there for more than 183 days within a year, whether the bonus incomes involved are subject to double taxation; if so, how the problem is to be solved; if not, of the reasons for that;

(i) after the Mainland and Hong Kong signed "The Arrangement between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income" in 2006, whether it has assessed if the situation of double taxation still exists; if it still exists, of the details; if not, how the authorities conducted the assessment;

(j) given that SFST stated that the authorities had raised the suggestion of relaxing the current 183-day threshold (i.e. remunerations derived by Mainland and Hong Kong residents from their employment in the Other Side shall be taxed in that Other Side if they are present in the Other Side for a period or periods exceeding in the aggregate 183 days in any 12-month period commencing or ending in the taxable period concerned) with the State Administration of Taxation, whether the authorities, apart from the discussions held in October 2009, have further discussed or examined the issue with the mainland authorities; if so, when such discussions or examinations were conducted and of the contents concerned; if not, the reasons for that; and

(k) whether the authorities have discussed or examined with the State Administration of Taxation the issues of improving the provisions for avoidance of double taxation and introducing special tax provisions for frontier workers; if so, of the details; if not, whether the Hong Kong authorities will take the initiative in liaising with the mainland authorities?

Reply:

President,

(a) According to the Commentary of the OECD Model Tax Convention, the "days of physical presence" method is the only method which is consistent with the wording of the Article on Income from Employment. Other tax jurisdictions have not made any reservation on this method in the Model Tax Convention.

(b) to (e) and (k) According to our understanding, European countries that have special tax provisions for frontier workers include France, Germany, Italy, Belgium and Switzerland. These countries levy tax on a worldwide basis.

In Hong Kong's circumstances, the issue of double taxation for people who work across the boundary in the Mainland (including frontier workers) can be dealt with in principle in accordance with "The Arrangement between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income" (the Arrangement). On the other hand, the introduction of special tax provisions will lead to double non-taxation of income derived from Hong Kong employments by frontier workers since most of the services are likely rendered outside Hong Kong.

The Inland Revenue Department (IRD) meets with the State Administration of Taxation on a regular basis to discuss the implementation of the Arrangement and areas for improvement. At the meeting held with the State Administration of Taxation last month, IRD raised the industry's suggestion on special tax provisions for frontier workers. Both sides consider that as the proposal may give rise to double non-taxation, it is not appropriate to introduce special tax provisions for frontier workers at this stage.

(f) The total number of claims for exemption of Hong Kong Salaries Tax under section 8(1A)(c) of the Inland Revenue Ordinance for the years of assessment 2009-10 and 2010-11 is as follows (IRD does not have statistical breakdown on cases relating to the Mainland) -

| <u>Year of Assessment</u> | <u>Number of Claims</u> |
|---------------------------|-------------------------|
| 2009-10 | 6,243 |
| 2010-11 | 10,731 |

IRD does not have the relevant statistics for years prior to 2009-10 nor the amount of tax involved for the cases of the above-mentioned two years.

(g) to (i) We believe that the Arrangement can reduce the incidence of double taxation that may be encountered by residents of the two sides. Generally speaking, the Mainland will only tax Hong Kong residents in respect of their remuneration derived from their work in the Mainland.

We will closely monitor the situation regarding any double taxation issue to ensure the effectiveness of the Arrangement. Any Hong Kong resident who considers that the tax authorities of one side or both sides have adopted measures leading to taxation not in accordance with the Arrangement (including taxation on bonus) can refer the case to IRD for review. If necessary, IRD will discuss the case with the Mainland competent authority.

(j) At the meeting with the State Administration of Taxation held last month, IRD raised again the matter of 183-day threshold. Both sides consider that the 183-day threshold should not be changed as it is an international standard which has been effectively applied.

Ends