

## **Press release**

### **Second Protocol to the Arrangement for the Avoidance of Double Taxation signed with the Mainland**

Wednesday, January 30, 2008

The Secretary for Financial Services and the Treasury, Professor K C Chan, signed the Second Protocol to the Arrangement for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with respect to Taxes on Income with the Mainland with the Deputy Commissioner of the State Administration of Taxation, Mr Wang Li, in Beijing today (January 30).

The Arrangement for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with respect to Taxes on Income between the Mainland and Hong Kong (including the protocol) was formally signed on August 21, 2006. The arrangement entered into force on December 8, 2006.

The Mainland and Hong Kong had different views on the interpretation of some of the articles upon implementation of the arrangement. After negotiation, both sides reached agreement on the necessary amendments to the agreement and initialled the second protocol as well as exchanged letters (annex) on September 11, 2007. At the same time, the new Enterprise Income Tax Law of the Mainland came into effect on January 1, 2008. Corresponding adjustment of the relevant articles of the arrangement had to be made in respect of tax types involved and the definition of a "resident".

In determining whether a Hong Kong enterprise providing services, including consulting services, in the Mainland is liable to the Enterprise Income Tax, both sides have now agreed to substitute "183 days" for "six months" as the basis of calculation.

In other words, Hong Kong enterprises would be considered as having a permanent establishment on the Mainland and be chargeable to tax if they provide services for an aggregate of 183 days in any 12-month period on the Mainland. The meaning of "month" was subject to different interpretations previously, for example the provision of services for only a few days within one calendar month on the Mainland might be counted as one month. The use of "day" in the present definition is clear and simple.

Apart from some specified transactions in the arrangement and the second protocol, the gains derived by a Hong Kong resident from the alienation of immovable assets should be taxable in Hong Kong only.

These specified transactions include alienation of a certain type of shares. The gains derived by a Hong Kong resident from the alienation of shares in a Mainland company may be taxed on the Mainland, if this company once owned at least 50% of immovable properties within three years prior to the alienation transaction. Furthermore, the gains derived by a Hong Kong resident from the alienation of shares, irrespective of the number of shares involved, in a Mainland company may be taxed on the Mainland, if within 12 months prior to the alienation transaction the vendor once owned not less than 25% of the entire shareholding of this Mainland company.

Investors can now estimate their tax liabilities with increased certainty as the second protocol has specified "three years" and "12 months" as the reference period in the implementation of the articles of the arrangement.

Hong Kong has entered into avoidance of double taxation arrangement/agreements (DTA) with the Mainland and other jurisdictions (including Belgium, Thailand, Luxembourg). This is the first occasion on which amendments are made to the articles of a DTA by signing a protocol, which is considered to be an important move in the proper implementation of a DTA.

During the day, Professor Chan and the Commissioner of Inland Revenue, Mrs Alice Lau, paid a courtesy call on the Commissioner of State Administration of Taxation, Mr Xiao Jie, and they exchanged views on issues of mutual concern. Professor Chan and Mrs Lau also visited the Beijing Municipal Office, State Administration of Taxation, to familiarise themselves with the work of the office.

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