

HONG KONG

2009/10 BUDGET PROPOSALS

On 25 February 2009, Hong Kong's Financial Secretary, Mr John Tsang, delivered his second budget speech. Compared with the relief contained in the 2008/09 budget, the tax concessions and handouts proposed in the 2009/10 budget are considered less generous. The Financial Secretary pledged to provide an update on the overall economic condition in the middle of this year. It remains to be seen whether further concessions or relief will be announced by the Hong Kong SAR Government later this year. The limited tax measures and one-off relief proposed in the 2009/10 budget are summarised below.

Profits tax

The profits tax rates for companies and unincorporated businesses remain unchanged at 16.5% and 15% respectively.

Salaries tax

There is no change in the marginal tax rates, marginal tax bands and personal allowances. The standard tax rate remains unchanged at 15%.

Government duties

The budget proposed to increase tobacco duty by 50% with immediate effect.

Other tax proposals

The following tax measures were proposed in the budget:

1. Amendments to the Hong Kong tax legislation to accommodate the international exchange of tax information requirements under avoidance of double taxation agreements. The related legislative proposal is planned to be put forward by the middle of fiscal year 2009/10.
2. Changes to, or clarifications of, the tax treatments with respect to stamp duty, profits tax and property tax for Islamic financial products in order to create a level playing field between Islamic financial products and conventional products. The related legislative proposal is planned to be submitted within fiscal year 2009/10.

The proposed measure in relation to Islamic financial products is welcomed by the public in general. Such measure should help promoting Hong Kong as a platform for the growing area of Islamic finance and consolidating Hong Kong's position as a financial centre. The proposal in relation to the liberalisation of exchange of tax information is discussed in more details in the section "Liberalisation of exchange of tax information".

One-off measures

1. Waiver of 50% of salaries tax and tax under personal assessment for 2008/09, subject to a ceiling of HK\$6,000, to be deducted from the taxpayer's final tax payable for the year.
2. Waiver of rates for the first two quarters of 2009/10, subject to a ceiling of HK\$1,500 per quarter for each rateable tenement.
3. A 20% rental reduction for most government properties and short-term tenancies of government land for three months.
4. An extension of the freeze on government fees and charges related to people's livelihood to 31 March 2010.

Effective date

At the time of writing, the above budget proposals have not yet been passed by the Legislative Council and may be modified or disapproved by the Council.

DEVELOPMENTS IN DOUBLE TAX AGREEMENT NETWORK

As the Hong Kong SAR Government continues its effort to negotiate new agreements and enhance the existing agreements, numerous developments of Hong Kong's double tax agreement (DTA) network took place during 2008. Such developments are summarised below.

Comprehensive avoidance of double taxation agreement between Hong Kong and Luxembourg

The governments of Hong Kong and Luxembourg signed a comprehensive avoidance of double taxation agreement (HK/Lux DTA) on 2 November 2007. The HK/Lux DTA entered into force on 20 January 2009. The DTA has effect in Hong Kong for years of assessment beginning on or after 1 April 2008 and in Luxembourg from 1 January 2008 retrospectively. For more details about the DTA and the related tax planning opportunities, please refer to our last issue of *Asia Pacific Tax Notes* published in May 2008.

Comprehensive avoidance of double taxation agreement between Hong Kong and Vietnam

A comprehensive avoidance of double taxation agreement between Hong Kong and Vietnam (HK/Vietnam DTA) was signed on 16 December 2008. The HK/Vietnam DTA will apply with effect, in Vietnam, from 1 January in the calendar year next following that in which the DTA enters into force and, in Hong Kong, from 1 April in the calendar year next following that in which the DTA enters into force. The HK/Vietnam DTA will enter into force after it has been ratified by both governments.

Some of the key features of the HK/Vietnam DTA are as follows:

1. The DTA provides limited benefits in withholding tax rates. The following is a comparison of the withholding tax rates for dividends, royalties and interest with and without the treaty:

	Dividend	Royalty	Interest
Vietnam non-treaty rate	Nil	10%	10%
Hong Kong non-treaty rate	Nil	4.95%/4.5% ²	Nil
Treaty rate	10% ¹	7%/10% ³	0%/10% ⁴

Notes

(1) Currently, there is no withholding tax on dividends in Vietnam after tax is paid on the profits out of which the dividends are declared. The 10% treaty rate represents the maximum rate applicable to dividends received by a Hong Kong resident should a withholding tax on dividends be levied in Vietnam in the future.

(2) The 4.95% rate applies to corporations whereas the 4.5% rate applies to unincorporated businesses/partnerships.

(3) The 7% rate applies to royalties for the use, or the right to use, any patent, design or model, plan, secret formula or process. The 10% rate applies in all other cases.

(4) The 0% rate applies to interest payments to the Hong Kong SAR Government and recognised institutions. The 10% rate applies in all other cases.

2. Currently, foreign companies performing business in Vietnam or having contracts with Vietnamese customers without establishing a legal entity in Vietnam are subject to “Foreign Contractor Withholding Tax” (FCWT) at various rates depending on the business activities performed (e.g. 10% on service fees of which 5% represents corporate income tax and 5% represents value added tax). The corporate income tax component of such FCWT will be eliminated under the HK/Vietnam DTA provided that a Hong Kong company does not carry on business in Vietnam through a permanent establishment (PE) in Vietnam.

3. The DTA does offer capital gain exemption in relation to gains derived by a Hong Kong resident from the alienation of less than 15% interest in a Vietnamese company that does not derive 50% or more of its asset value directly or indirectly from immovable property situated in Vietnam. Currently, a gain derived by a foreign investor on the transfer of interests in a foreign invested or Vietnamese company is generally subject to Vietnam tax.
4. Under article 5 of the HK/Vietnam DTA, a PE is defined to include provision of services by an enterprise if the services continue (for the same or connected project) for a period or periods aggregating more than 180 days within any 12-month period.
5. As far as employment income is concerned, Hong Kong employees will be exempt from Vietnamese personal income tax provided that: (1) they do not spend more than 183 days in Vietnam in any 12-month period commencing or ending in the fiscal year concerned; (2) their remuneration is not paid by, or on behalf of, an employer who is a resident of Vietnam; and (3) the remuneration is not borne by a PE in Vietnam.
6. Similar to the other DTAs that Hong Kong has entered into so far, the Exchange of Information (EoI) article included in the HK/Vietnam DTA is the more restrictive 1995 version of the Organisation for Economic Cooperation and Development (OECD) model convention.
7. The DTA also contains “Associated Enterprises” and “Mutual Agreement Procedure” articles similar to those in Hong Kong’s other DTAs, as well as provisions to eliminate double taxation that include relief for tax spared as a result of tax incentives granted under Vietnam’s provisions for encouraging foreign investment for development purposes. However, the tax sparing provisions may be of limited use as Hong Kong does not tax offshore income.



Hong Kong

Latest negotiations of double tax agreements

The table below summarises the latest negotiations took place between the governments of Hong Kong and other countries during 2008.

Country	Round of negotiation	Date of negotiation
Austria	1 st round	5 June 2008
Kuwait (*)	2 nd round	25 June 2008
	3 rd round	11 December 2008
The Netherlands	4 th round	5 December 2008

(*) *Hong Kong and Kuwait initialled an agreement on avoidance of double taxation on 11 December 2008, pending formal signing of the agreement. No details of the agreement are available at the time of writing.*

LIBERALISATION OF EXCHANGE OF TAX INFORMATION

Hong Kong has so far signed a comprehensive DTA with Belgium, Thailand, the Mainland of China, Luxembourg and Vietnam only. A major obstacle in the DTA negotiations between Hong Kong and other jurisdictions comes from a disagreement on the Eol article. The Eol article currently adopted by Hong Kong is based on the more restrictive 1995 version of OECD model tax convention whereas most of the developed economies (particularly OECD members) have adopted a more liberal Eol article that is

based on the 2004 version of OECD model tax convention. Under the 1995 version of the Eol article, only information necessary for carrying out the provisions of the DTA or of the domestic laws concerning taxes covered by the agreement can be exchanged and the Hong Kong Inland Revenue Department (HKIRD) can refuse to provide the information requested by another jurisdiction if the HKIRD does not need such information for its own domestic tax purposes. The 2004 version of the Eol article imposes an obligation for a jurisdiction to supply information requested by another jurisdiction even though the information may not be required for its own domestic tax purposes. Due to the constraints under the existing tax laws of Hong Kong under which the HKIRD can only exercise its information seeking power for domestic tax purposes, the Inland Revenue Ordinance (IRO) would need to be amended if Hong Kong would like to adopt the 2004 version of the Eol article.

In view of the above, the Hong Kong SAR Government conducted two rounds of consultation on the liberalisation of Eol article for DTAs with the business and professional community to solicit their views on this issue since 2005. Following the 2nd round of consultation in October 2008, as mentioned above, the 2009/10 budget contained a proposal to amend the existing provisions of the IRO in order to accommodate the more liberal exchange of tax information requirements endorsed by the OECD. It remains to be seen whether this budget proposal can be enacted into law within fiscal year 2009/10.

