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Mrs. Lau Mak Yee-ming, Alice
Commissioner
Inland Revenue Department
Revenue Tower,
5 Gloucester Road,
Wan Chai,
Hong Kong

Dear Mrs. Lau,

We are aware of an upcoming meeting between representatives of your Department and the State Administration of Taxation ("**SAT**") to discuss issues related to the administration of 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* ("**Arrangement**"). Please allow us the opportunity to share our views and concerns on one particular issue, which effects the clients of our membership and which we hope will be a topic of discussion during the meeting.

Let us first comment that we see the Arrangement as one of the cornerstones for the development and enhancement of the commercial relationships between the Mainland and Hong Kong. Since its entry into force, any foreign entity wishing to establish itself on the Mainland is invariably compelled to consider Hong Kong as a stepping stone to its entry into the Mainland and, more often than not, will choose Hong Kong over other options because of the favourable provisions of the Arrangement. Accordingly, in our view, anything that undermines the favourable provisions of the Arrangement will eventually affect Hong Kong's competitive position.

We note that, already, some of the favourable provisions of the Arrangement have been diluted because of practices on the Mainland that undermine the provisions of the Arrangement. For instance, prior to the *Second Protocol to the Arrangement for the Avoidance of Double Taxation signed with the Mainland*, favourable provisions on capital gains or permanent establishment, which appeared on their face clear and unambiguous, were subject to practices of the Mainland which did not seem to accord with the terms of the Arrangement. Thankfully, the Second Protocol managed to blunt some of the negative impact of the relevant practices but the end result is still less favourable than what would have been the case if the terms of the Arrangement, as initially drafted, had simply been applied.

One of the most attractive features of the Arrangement is the ease under which a company can be considered a resident of Hong Kong for the purposes of the Arrangement. Pursuant to Article 4(2)(iii) of the Arrangement, any company incorporated in Hong Kong will be considered a "resident of Hong Kong" for the purposes of the Arrangement. The drafting in the Arrangement to define a company

"resident of Hong Kong" is unique and clearly different from the definition applied in all of the other double tax treaties that the Mainland has entered into. This test is simple to apply and should be easy to administer to the extent that all one should have to produce is a valid certificate of incorporation. Arguably, this is one of the main features which make Hong Kong so attractive when considering entry into the Mainland. Anything that undermines this test will eventually be harmful to Hong Kong's position.

The problem our members have encountered in recent times is that Mainland authorities (whether at local or other levels) are never satisfied with mere presentation of a certificate of incorporation when a Hong Kong company seeks favourable treatment under the Arrangement. Invariably, Mainland authorities request all sorts of documents before accepting the status of a company incorporated in Hong Kong as a resident for the purposes of the Arrangement. In fact, they often compel taxpayers to obtain a specific certificate of residency from your Department before acknowledging the right of the taxpayer to claim the benefits of the Arrangement.

Moreover, since the introduction of the *Enterprise Income Tax* in the Mainland, the SAT (and others) have increased their attention on anti-avoidance and one of their focus concerns specifically what entities are eligible for favourable treatment under a tax treaty. For instance *Guo Shui Fa [2009] No 124 - Administrative Measures for Non-Tax residents to Enjoy Treatments on Income under a DTA (Trial)* provides for the filing of a host of information about the non-resident enterprise, specifically to assess whether a taxpayer is entitled to the treaty benefit as a resident of the other jurisdiction. Other Circulars also provide for (sometime) additional conditions, all of which related to establishing the right of the particular entity to the specific benefits afforded to residents of the other jurisdiction.

We are concerned that the conditions imposed by those Circulars are incompatible with the simple test provided in the Arrangement and believe the SAT should be asked to clarify how these practices are intended to apply for the purposes of the Arrangement. We propose that one easy way to resolve any issue would be to provide that Circulars dealing with treaty benefits would not apply to the Arrangement since it is not a tax treaty (协定) between two countries but an arrangement (安排) within China. This should be perfectly admissible without affecting international commitments that the Mainland may have since the relationship between Hong Kong and the Mainland is a matter of Chinese internal affairs. The SAT could then issue a Circular dealing specifically with Hong Kong which would streamline the requirements for demonstrating eligibility to the benefits of the Arrangement to mere presentation of a certificate of incorporation in accordance with the terms of the Arrangement.

We hope that your upcoming meeting will clarify and resolve favourably this particular matter.

On Hong Kong's part, if the Mainland is insistent on obtaining a Hong Kong residency certificate for Hong Kong incorporated companies, perhaps the Department would consider putting in place a simple application process to provide such certificate. At the moment, the Department only provides an application form

for non-Hong Kong incorporated companies to apply for a residency certificate (form 1313A). The notes of form 1313A states that "company incorporated in Hong Kong under the provisions of the Companies Ordinance (Chapter 32) needs not apply for a certificate of resident status from this Department. Such company should produce to the Mainland tax authorities a copy of its Certificate of Incorporation in Hong Kong or a Certified Extract of Information on the Business Register to prove its Hong Kong resident status.".

Yours sincerely,

Carolyn Butler
Chairman
Hong Kong Trustees' Association Ltd