



International Taxation – Opportunities and Challenges

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Background of international taxation

1. The power to make tax legislation, and to levy tax is deeply bound with the notion of sovereignty
2. In an increasingly globalised economic context, different tax regimes may be incompatible, or produce un-commercial results, such as taxing the same income stream or capital gain twice or tax asymmetry
3. The solution is double tax treaties (DTTs) – these are bilateral instruments governed by public international law that allocate taxing rights between jurisdictions
4. Hong Kong is not a sovereign state, but has delegated authority to make its own tax legislation (Article 106) and to negotiate international agreements in certain domains (Article 116) relevantly including taxation

How DTTs operate

- Bilateral arrangement and cannot bind third parties
- Hong Kong has a common law system, which is dualistic
- Important concepts include:
 - Treaty residence – the DTT applies only to residents of one contracting party or the other
 - Permanent Establishment – where a person resident in one contracting party has a taxable presence in the other contracting party
 - Transfer pricing – arm's length principle
 - Beneficial ownership of income and gains
 - Withholding tax (WHT) – tax withheld by the payor at source
 - Dividends, royalties, and interest
 - Lower rates of WHT can be provided for in the DTT
 - Crucial aspect of tax planning through DTTs

Tax planning opportunities and challenges

International tax structuring

- DTTs are useful in tax planning:
 - Minimise taxation, and avoid double taxation
 - Provide legal certainty on the tax treatment of cross-border transactions
 - Dispute resolution mechanism in most DTTs by way of Mutual Agreement Procedure and Exchange of Information clauses
- Hong Kong is an advantageous structuring jurisdiction:
 - WHT of 4.95 (in general) on royalties and no WHT on interest and dividends
 - Dividends not tax on receipt
 - No capital gains tax
 - Light-touch tax compliance regime
 - Good double taxation agreement with China
- But there are challenges:
 - Need 'economic substance' to obtain certificate of resident status from Hong Kong Inland Revenue Department
 - Treaty abuse and treaty shopping – OECD measures to counter Base Erosion and Profit Shifting
 - Principal purpose test in art. 7 of the Multilateral Instrument

Current and future trends

- Multilateralism and the influence of the OECD
- From litigation to arbitration?
- Domestic and international anti-abuse and anti-avoidance provisions
- Revenue authorities seeking to align tax with value creation
- Tax incentives discouraged – can the territorial system of jurisdictions like Hong Kong, Singapore, and Malaysia survive?



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