



Hong Kong

January 2016

## HONG KONG AND RUSSIA SIGN DOUBLE TAXATION AGREEMENT

### Introduction

Hong Kong and Russia signed an agreement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income<sup>1</sup> ('Russia Hong Kong Double Tax Agreement' or 'Agreement') on 18 January 2016. This is the 34<sup>th</sup> double taxation agreement signed by Hong Kong and it is expected to boost economic and trade connections between Hong Kong and Russia.

The underlying purposes of the Russia Hong Kong Double Tax Agreement are to facilitate business and improve capital flows between Russia and Hong Kong, minimise the incidence of double taxation between the two countries, and limit fiscal evasion in accordance with international standards on transparency. An important advantage of the Agreement is that it will enhance Hong Kong's position as an international investment hub, making Hong Kong a gateway for the flow of capital between Russia and Mainland China.

The Agreement offers incentives for Russian companies to do business or invest in Hong Kong and vice versa.

For Hong Kong investors and businesses, key advantages of the Russia Hong Kong Double Tax Agreement include:

- Russia's dividend withholding tax rate is reduced from 15% to either 10% or 5%. The lower rate applies where the beneficial owner of the dividends is a company which directly holds at least 15% of the company paying the dividends;
- Russia's withholding tax rate on royalties is reduced to a maximum of 3% from 20% for companies and 30% for individuals; and
- Hong Kong airlines operating flights to Russia will only be taxed in Hong Kong. Profits from international shipping transport earned by Hong Kong residents arising in Russia, which are currently subject to Russian tax, will not be taxed in Russia under the Agreement.

In the absence of a double tax treaty, income earned by Russian residents in Hong Kong is subject to both Hong Kong and Russian tax. Under the Agreement, tax paid in Hong Kong will be allowed as a credit against the tax payable on the same income in Russia. For Russian investors and businesses, a key advantage of the Agreement is that Hong Kong's withholding tax rate on royalties is reduced to a maximum of 3% from 4.95% for companies and 4.5% for individuals (and from 16.5% for companies and 15% for individuals if the royalties are received by or accrued to an associate). This may also have advantages for Russian companies who structure their investments in China through Hong Kong companies. There are no withholding taxes in Hong Kong on dividends or interest.

<sup>1</sup> Agreement between the Government of the Hong Kong Special Administrative Region of the People's Republic of China and the Government of the Russian Federation for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income at [http://www.ird.gov.hk/eng/pdf/Agreement\\_Russia\\_HongKong.pdf](http://www.ird.gov.hk/eng/pdf/Agreement_Russia_HongKong.pdf)

Each side is required to give written notice to the other of the completion of the procedures required by its law to give effect to the Russia Hong Kong Double Tax Agreement. The Agreement will come into force on the date of the later of these notifications and will apply to Hong Kong tax for any year of assessment beginning on or after 1 April in the calendar year following that in which the Agreement comes into force. In the case of Russian tax, the Agreement will apply for years of assessment beginning on or after 1 January in the calendar year following that in which the Agreement comes into force.

## Scope of Taxes

The Russia Hong Kong Double Tax Agreement applies to taxes on income, including taxes on gains from movable or immovable property. In the case of Hong Kong, the Agreement applies to profits tax, salaries tax and property tax, whilst in the case of Russia, the Agreement applies to tax on profits of organizations and tax on income of individuals.

## Residence

A critical term of the Russia Hong Kong Double Tax Agreement is the definition of a resident, especially in the case of Hong Kong where there is no definition under Hong Kong law generally. A resident of Hong Kong is defined as any individual who ordinarily resides in Hong Kong, or stays in Hong Kong for more than 180 days during a tax year or more than 300 days in two consecutive tax years. A company is a resident in Hong Kong if it is incorporated in Hong Kong, or in the case of a foreign company, it is normally managed or controlled in Hong Kong. Any other legal entity will be resident in Hong Kong if it is constituted under Hong Kong laws or, if constituted elsewhere, it is normally managed or controlled in Hong Kong.

A resident of Russia means any person who, under Russian law, is liable to tax by reason of domicile, residence, place of effective management, place of incorporation or any similar criteria. A person would not be considered to be a resident of Russia for the purpose of the Agreement where that person is liable to tax in Russia in respect only of income from sources in Russia.

The Agreement provides a series of rules to determine residency status when an individual is a resident of both Russia and Hong Kong (each a "Contracting Party"). In the case of a person other than an individual (e.g. a corporation) which is resident in both Contracting Parties, that person is deemed to be a resident in the Contracting Party in which its place of effective management is located.

## Permanent Establishment

Under Article 5, the term permanent establishment is defined as a fixed place of business through which the business of an enterprise is wholly or partly carried on. A permanent establishment includes a place of management, a branch, an office, a factory, a workshop, or a mine or any other place of extraction of natural resources. A permanent establishment may also include the furnishing of services, including consultancy services by an enterprise, but only if such services continue within a Contracting Party for periods aggregating more than 183 days within any twelve-month period. Certain activities are deemed not to be a permanent establishment, for example, the use of facilities solely for the purpose of storage of goods belonging to the enterprise.

An enterprise will not be deemed to have a permanent establishment in a Contracting Party merely because it carries on business in that Party through an independent agent (e.g. a broker) provided that the agent is acting in the ordinary course of business. The fact that a company which is a resident in a Contracting Party controls or is controlled by a company which is a resident in the other Contracting Party, or which carries on business in that other Party (whether through a permanent establishment or otherwise), will not of itself constitute either company a permanent establishment of the other.

## Business Profits

Under Article 7 of the Russia Hong Kong Double Tax Agreement, profits of an enterprise of a Contracting Party will be taxable only by that Contracting Party, unless the enterprise carries on business as a permanent establishment in the other Contracting Party. The term "an enterprise of a Contracting Party" means an enterprise carried on by a resident of a Contracting Party. A Contracting Party may tax the profits of an enterprise of the other Contracting Party where that enterprise carries on a business as a permanent establishment in that Contracting Party, but only to the extent that the profits are attributable to the permanent establishment. The profits attributable to a permanent establishment are those profits which it might be expected to make if it were a distinct and separate enterprise engaged in similar activities under similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

## Associated Enterprises

The Russia Hong Kong Double Tax Agreement also provides for the taxation of associated enterprises. Under Article 9, enterprises will be associated enterprises where:

- a) an enterprise of a Contracting Party participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting Party; or
- b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting Party and an enterprise of the other Contracting Party,

and conditions are imposed in their commercial or financial relations which differ from those which would be made between independent enterprises. In this case, any profits which would, but for those conditions, have accrued to one of the enterprises, but have not so accrued because of those conditions, may be included in the profits of that enterprise and taxed accordingly.

Business profits of an enterprise in one Contracting Party may also include the profits of an associated enterprise in the other Contracting Party where those transactions are not at arm's length. However, if a Contracting Party makes adjustment for profits in what is commonly known as transfer pricing rules, the other Contracting Party is obliged to also make an adjustment in its taxation.

## Dividends

Dividends are defined to include income from shares or other rights, not being debt claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the laws of the Party of which the company making the distribution is a resident.

The Russia Hong Kong Double Tax Agreement does not prescribe that dividends are to be taxed either exclusively in the jurisdiction of the beneficiary's residence or exclusively in the jurisdiction of the company's residence.

Article 10(1) provides that dividends paid by a company which is a resident of a Contracting Party to a resident of the other Contracting Party may be taxed by that other Party. Under Article 10(2), dividends may also be taxed in the Party in which the company paying the dividends is resident, that is

the source of the dividends. The right of a Contracting Party to tax on the basis of source of dividends is limited to 10% of the gross amount of the dividends. However, the tax rate is lowered to 5% in respect of dividends paid by a company to another company which holds at least 15% of the capital of the company paying the dividends. This measure is aimed at avoiding recurrent taxation and facilitating international investment.

There are exemptions in relation to dividends paid to various bodies, including the Contracting Parties' governments, state-owned enterprises and central banks.

The limitations under paragraphs 1 and 2 of Article 10 do not apply where the beneficial owner of the dividends is a resident of one Contracting Party and carries on business through a permanent establishment or performs independent personal services from a fixed base in the other Contracting Party of which the company paying the dividends is a resident, and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment or fixed base.

The Russia Hong Kong Double Tax Agreement precludes the extra-territorial taxation of dividends, that is a Contracting Party's taxation of dividends distributed by a non-resident company only because the profits or income from which the distributions are made arose in that Party. There are two exceptions: (i) for dividends paid to a resident of that Party, or (ii) where the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or a fixed base situated in that other Party. Article 5(6) further provides that non-resident companies are not to be subjected to special taxes on undistributed profits.

Article 10 does not apply if the main purpose or one of the main purposes of any person concerned with the creation or assignment of the shares or other rights in respect of which the dividend is paid was to take advantage of this Article by means of that creation or assignment.

## Interest and Royalties

In contrast to the 2014 OECD Model Tax Convention on Income and on Capital, Article 11 of the Russia Hong Kong Double Tax Agreement stipulates an exclusive right to tax interest in favour of the state of residence. In particular Article 11(1) provides that interest arising in a Contracting Party and paid to a resident of the other Contracting Party will be taxable only by that other Party. This restriction does not however apply where the beneficial owner of the interest carries on business

through a permanent establishment or performs independent personal services from a fixed base in the other Contracting Party in which the interest arises, and the debt-claim in respect of which interest is paid is effectively connected with such permanent establishment or fixed base (Article 11(3)). In this case, the provisions of Article 7 (Business Profits) or Article 14 (Income from Independent Personal Services) will apply.

Interest is widely defined to mean income from debt-claims of every kind, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures.

Royalties are not subject to an exclusive taxation rule. Article 12 provides that royalties arising in a Contracting Party and paid to a resident of the other Contracting Party may be taxed by that other Party. However, such royalties may also be taxed in the Contracting Party in which they arise and according to the laws of that Party, but if the beneficial owner of the royalties is a resident of the other Contracting Party, the tax so charged must not exceed 3% of the gross amount of the royalties. This limitation will not however apply where the beneficial owner of the royalties carries on business through a permanent establishment or performs independent personal services from a fixed base in the other Contracting Party in which the royalties are paid and the right or property in respect of which the royalties are paid is effectively connected with such permanent establishment or fixed base (Article 12(4)).

Royalties are defined as payments of any kind received as consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, or films or tapes used for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process.

Under Articles 11(4) and 12(5), interest and royalties respectively will be deemed to arise in a Contracting Party when the payer is a resident of that Party – the Contracting Party of the source of interest or royalties is the Contracting Party of which the payer of the interest or royalties is a resident.

Under the Russia Hong Kong Double Tax Agreement, there are restrictions in the operation of the provisions concerning both the taxation of interest and the taxation of royalties in cases where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest or royalties paid

exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship. In such cases the excess part of the interest or royalties will remain taxable according to the laws of each Contracting Party, due regard being had to the other provisions of the Agreement.

Articles 11 and 12 which deal with interest and royalties respectively, do not apply if the main purpose or one of the main purposes of any person concerned with the creation or assignment of the debt-claim in respect of which interest is paid (Article 11(6)) or rights in respect of which the royalties are paid (Article 12(7)) was to take advantage of Article 11 or 12 by means of that creation or assignment.

### Capital Gains

Article 13(1) provides that gains derived by a resident of a Contracting Party from the alienation of immovable property (e.g. real estate) located in the other Contracting Party may be taxed by that other Party.

The Russia Hong Kong Double Tax Agreement further provides for capital gains taxation in connection with movable property. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting Party has in the other Contracting Party, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise), may be taxed by that other Party. Unlike the 2014 OECD Model Tax Convention, there is also provision for gains arising from the alienation of movable property pertaining to a fixed base available to a resident of a Contracting Party in the other Contracting Party for the purpose of performing independent personal services to be taxed by that other party.

The right to tax capital gains derived from the alienation of shares is provided for under Article 13 of the Agreement. Where a resident of a Contracting Party derives a gain from the alienation of shares of a company which derives more than 50% of its asset value directly or indirectly from immovable property situated in the other Contracting Party, that other Party may tax such gains. This limited right to tax capital gains does not apply to gains derived from the alienation of shares: (a) quoted on such stock exchanges as may be agreed between the Parties; or (b) alienated or exchanged in the framework of a reorganisation of a company, a merger, a scission or a similar operation; or (c) in a company deriving more than 50% of its asset value from immovable property in which it carries on its business.

Gains from the alienation of any property which is not expressly dealt with in Article 13 (i.e. immovable property, movable property, ships or aircraft, and shares) will only be taxable in the Contracting Party of which the alienator is a resident.

The provisions of Article 13 do not apply if the main purpose or one of the main purposes of any person concerned with the alienation in respect of which the gain is realised, was to take advantage of this Article by means of that alienation.

### **Independent Personal Services, Employment and Director Fees**

The Russia Hong Kong Double Tax Agreement provides for the taxation of income from independent personal services (Article 14), income from employment (Article 15) and directors' fees (Article 16). Article 14 concerning independent personal services has been deleted from the OECD Model Tax Convention.

Under the Agreement, income derived by a resident of a Contracting Party in respect of professional services or activities of an independent character will be taxable only by that Party unless he has a fixed base regularly available to him in the other Contracting Party for the purpose of performing his activities. Where there is such a fixed base, the income may be taxed by the other Party but only to the extent to which that income is attributable to that fixed base. The phrase professional services in Article 14 includes independent scientific, literary, artistic, educational or teaching activities, and independent activities of lawyers, accountants, physicians, dentists, engineers and architects.

Salaries, wages and other similar remuneration derived by a resident of a Contracting Party in respect of employment, will be subject to taxation only by that Party, unless the employment is exercised in the other Contracting Party. Where employment is so exercised, such remuneration may be taxed by that other Party except where: (i) the recipient is present in the other Party for a period or periods which in aggregate do not exceed 183 days in any twelve-month period; (ii) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other party; or (iii) the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other Party. The right to tax other employment related activities, such as income from government service, pensions and directors' fees are subject to separate provisions.

In the case of directors' fees and other similar payments derived by a resident of a Contracting Party in his capacity as a member of the board of directors of a company which is a resident of the other Contracting Party, that other Party has the right to tax such fees. In effect, the services of directors are treated as being performed in the company's state of residence.

### **Information Exchange**

Article 25 provides for the exchange of information between the Hong Kong and Russian tax authorities in relation to taxes covered by the Agreement. There are a series of treaty safeguards in relation to the exchange of information. The information which can be exchanged under the Agreement is information that is foreseeably relevant for carrying out the Agreement or to the administration or enforcement of the internal laws of the Contracting Parties concerning taxes. The Contracting Party that receives information under the Agreement must treat such information as secret in the same manner as information obtained under internal laws of that Party. The information can be disclosed only to persons or authorities concerned with the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to the taxes covered by the Agreement. There is no obligation to supply information under certain conditions, such as where the information would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy.

The Article does not require the Contracting Parties to exchange information on an automatic or a spontaneous basis. Any information exchanged cannot be disclosed to any third jurisdiction.

### **Conclusion**

The Russia Hong Kong Double Tax Agreement provides a useful framework for minimising double taxation but will be most important in facilitating new opportunities for business and financial transactions between the two countries. The Agreement is comprehensive in that it covers a wide range of taxes, including business profits, passive income and capital gains.



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