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One Country, Two (Taxation) Sytems: A Treaty in All But Name

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ONE COUNTRY, TWO (TAXATION) SYSTEMS: A TREATY IN ALL BUT NAME

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Abstract: It came as no small surprise when it was announced in February 1998 that the Chinese mainland ("the Mainland") and Hong Kong had agreed to enter into an arrangement for the avoidance of double taxation of income. Although concerns of double taxation between the Mainland and Hong Kong tended to be more academic than practical, this arrangement helps establish a firm foundation for future co-operation by the Mainland and Hong Kong on trade and other economic matters. From a Hong Kong taxation perspective, it is one of the most significant developments to have occurred for a very long time. From a broader perspective, the Mainland has adopted a flexible and innovative approach to taxation issues related to Hong Kong. A standard treaty template, based upon the OECD Model Double Taxation Convention, has been used to regulate jurisdiction to tax within different parts of the People's Republic of China. This augurs well for China's effort to effectively implement the autonomy promised to Hong Kong under the challenging rubric of "one country, two systems."

I. INTRODUCTION

At least since the late 1980s, those interested in Hong Kong commercial law have debated whether Hong Kong should endeavor to enter into comprehensive double taxation agreements with targeted partners.[1] Although it was appreciated that, for the most part, instances of double taxation were more theoretical than practical,[2] the one area where concern was continually expressed was cross-border activities related to the Chinese mainland ("the Mainland").[3] In those debates, Hong Kong professional and commercial

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1 *See* TAX TREATIES FOR HONG KONG? (Andrew Halkyard ed., 1991); Richard Cullen, *Double Tax Treaties in Hong Kong*, COMPANY SECRETARY, Nov. 1996, at 32; Dick Rijntjes, *Does Hong Kong Need Tax Treaties?*, 3 ASIA-PAC. TAX BULL. 34 (1997).

2 This is because of Hong Kong's limited jurisdiction to tax, which is based almost entirely upon the concept of source. *See generally* Hong Kong Inland Revenue Department, Departmental Interpretation and Practice Notes No. 29: Tax Relations Between the Hong Kong Special Administrative Region and the People's Republic of China (Aug. 1997) <http://www.info.gov.hk/ird/ipn29.htm> [hereinafter DIPN No. 29]. By way of contrast, see Deborah Annells, *China/Hong Kong: Tax Planning and Avoiding Double Taxation*, 4 ASIA-PAC. TAX BULL. 14 (1998); AVOIDING DOUBLE TAXATION IN HONG KONG AND CHINA (Jefferson VanderWolk ed., 1996); and THE TAXATION COMMITTEE OF THE HONG KONG SOCIETY OF ACCOUNTANTS, A STUDY OF DOUBLE TAXATION BETWEEN HONG KONG AND THE PRC (1998), which describe various instances in which double taxation could arise.

3 *See* Dow Famulak & Stephen Adams, *Arrangement Between Mainland China and Hong Kong for the Avoidance of Double Taxation on Income*, TAX J., Mar.-Apr. 1998, at 15; David Liu, *Double Taxation of Income in Hong Kong and China*, CHINA TAX REV., Apr.-June 1998, at 1.

groups, most notably the Hong Kong General Chamber of Commerce and the Hong Kong Society of Accountants, supported the view that some form of agreement was needed to resolve problems of double taxation between Hong Kong and the Mainland.[4] However, notwithstanding the lobbying of such organizations, the conventional wisdom appeared to be that given the practical and political difficulties that would need to be overcome under the "one country, two systems" concept,[5] no formal agreement between the Mainland and Hong Kong could ever be concluded in the taxation arena.[6]

It thus came as no small surprise when the Financial Secretary of the Hong Kong Special Administrative Region ("Hong Kong SAR") announced in his 1998-99 Budget Speech[7] that the Hong Kong SAR had entered into an arrangement with the taxation authorities of the Mainland for avoidance of double taxation between the Mainland and Hong Kong (the "Arrangement").[8] The Arrangement, which is set out in a memorandum signed in Hong Kong on February 11, 1998, covers matters such as shipping, aviation, land

[4] *See* Famulak & Adams, *supra* note 3.

[5] Under the principle of "one country, two systems," the socialist system and policies practiced in the Mainland shall not be practiced in Hong Kong and the previous capitalist system and way of life in Hong Kong shall not be changed for 50 years after July 1, 1997. This principle is reflected in the Sino-British Joint Declaration of 1984 and enshrined in Hong Kong's Basic Law. Under these documents, Hong Kong is promised a high degree of autonomy and the right to practice its own laws and taxation system independently. *See generally* YASH GHAI, HONG KONG'S NEW CONSTITUTIONAL ORDER: THE RESUMPTION OF CHINESE SOVEREIGNTY AND THE BASIC LAW (2d ed. 1999). As Yash Ghai states in the title of his text, the constitutional order after July 1, 1997 is that the PRC has resumed sovereignty over Hong Kong. Notwithstanding Hong Kong's "high degree of autonomy," it is the fact of reunification that seemed to preclude any "treaty" being entered into between two parts of the same country. *See also* Liu, *supra* note 3.

[6] *See* DIPN No. 29, *supra* note 2 (particularly the extract from the speech of the Deputy Commissioner of the State Administration of Taxation in the Mainland, Xiang Huaicheng).

[7] *See* Honorable Donald Tsang, Hong Kong Financial Secretary, Speech on the 1998-99 Budget: Riding Out the Storm, Renewing Hong Kong Strengths ¶ 115 (Feb. 18, 1998), *translated in* Hong Kong Special Administrative Region of the People's Republic of China Homepage (visited Feb. 21, 2000) <http://www.info.gov.hk/fb/bdgt98/english/eindex.htm>. In his speech, the Financial Secretary stated:

> The matter of double taxation is a concern for many of our businesses. We are addressing this in a number of ways. . . . We have reached an understanding with the relevant authorities in the Central People's Government on tax relief for Hong Kong airlines and shipping companies, and for avoidance of other cases of double taxation between the Mainland and Hong Kong. This will enhance cross-border business activities and strengthen the competitiveness of Hong Kong business operating in the Mainland.

Id.

[8] Arrangement Between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation on Income, art. 2, para. 1 [hereinafter Arrangement], *reprinted in* Hong Kong Inland Revenue Department, Departmental Interpretation and Practice Notes No. 32: Arrangement Between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation on Income (June 1998) <http://www.info.gov.hk/ird/ipn32.htm> [hereinafter DIPN No. 32].

transportation, permanent establishments, services, and personal taxation.[9] It applies to direct taxation of certain income and profits derived by individuals and enterprises. With one exception, the Arrangement does not apply to indirect taxation.[10] The Arrangement concentrates on active income and is silent on passive income, which typically is subject to withholding tax.[11]

The Arrangement was drafted in the Chinese language; the English version is merely a "translation." Therefore, to the extent of any inconsistency between the Chinese and English versions of the law, the Chinese version, as the authentic text, must prevail.[12] The Arrangement entered into force on April 10, 1998, when the two sides respectively completed the requisite approval procedure and notified each other in writing thereof. In Hong Kong, the Arrangement took effect with respect to income derived in any year of assessment commencing on or after April 1, 1998.[13] In the Mainland, it took effect with respect to income derived on or after July 1, 1998.[14] Perhaps the most surprising aspect of the Arrangement is the impressive speed with which it was reached. The Arrangement was finalized after only two formal meetings between representatives of the respective taxation authorities.[15]

In June 1998, the Hong Kong Inland Revenue Department issued Departmental Interpretation and Practice Notes No. 32, entitled "Arrangement Between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation on Income" ("Hong Kong Practice Note").[16] Around the same time, the Mainland's State Administration

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[9] *See* L.N. 126 of 1998: Specification of Arrangements (Arrangements with the Mainland of China for the Avoidance of Double Taxation on Income) Order [hereinafter L.N. 126 of 1998], *reprinted in* DIPN No. 32, *supra* note 8.

[10] The exception is found in Article 2, Paragraph 1 of the Arrangement, in which the Mainland grants an exemption from business tax for income derived by Hong Kong residents from shipping, aviation, and land transport operations. Arrangement, *supra* note 8, art. 2, para. 1. Indirect taxation remains of critical importance, however, in the Mainland context. The most significant of these indirect taxes are the value added tax and the business tax.

[11] *See also* Bill Chan, *China and Hong Kong Enter into Double Tax Arrangement*, 16 TAX NOTES INT'L 966, 967 (1998).

[12] *See* L.N. 126 of 1998, *supra* note 9, ¶ 2.

[13] *See* DIPN No. 32, *supra* note 8, ¶¶ 7-8.

[14] Guojia Shuiwu Zongju Guanyu "Neidi he Xianggang Tebie Xingzhengqu Guanyu Dui Suode Bimian Shuangchong Zhengshui de Anpai" You Guan Tiaowen Jieshi he Zhixing Wenti de Tongzhi [Notice of the State Administration of Taxation Concerning Issues in the Interpretation and Implementation of Relevant Articles of the "Arrangement Between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation"] Guo Shui Han (1998) No. 381 (issued June 26, 1998) para. 5 [hereinafter 1998 Mainland Tax Notice No. 381], *reprinted in* China Infobank, China Laws and Regulations File (visited Jan. 24, 2000) <http://www.chinainfobank.com> [hereinafter China Infobank].

[15] Notes of Meeting with Hong Kong Inland Revenue Department Official, Hong Kong (Mar. 25, 1998).

[16] DIPN No. 32, *supra* note 8.

of Taxation issued the "Notice of the State Administration of Taxation Concerning Issues in the Interpretation and Implementation of Relevant Articles of the Arrangement Between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation on Income" ("Mainland Notice").[17] The Hong Kong Practice Note and the Mainland Notice contain general reference material that assists in understanding the Arrangement, sets out the interpretation given by each side to various provisions of the Arrangement, and describes the practice each side will adopt in applying the Arrangement.

II. THE ARRANGEMENT

For the reasons alluded to above, there could be no thought of a treaty between the Mainland and the Hong Kong SAR. Indeed, the understanding reached is not even termed an agreement. Rather, in the memorandum setting out its terms, it is simply called an "arrangement." As will be shown below, however, the Arrangement *is* a treaty in all but name—albeit a fairly restricted treaty.

Many of the PRC's tax treaties are based upon the 1977 Organisation for European Co-operation and Development ("OECD") Model Double Taxation Convention,[18] or contain a combination of OECD and United Nations model agreement provisions.[19] The speed at which the Arrangement was reached clearly indicates that its terms were familiar to both sides. The result is a simplified arrangement which covers basic matters only and which adopts standard OECD wording. For ease of reference, a brief summary of the Arrangement's provisions, considered from a Hong Kong perspective (but equally applicable from the converse Mainland perspective), is

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[17] *See supra* note 14.

[18] In 1977, the OECD issued the Model Double Taxation Convention on Income and on Capital. This model convention, which generally gives the primary right of taxation to the state of residence rather than that of source, has been highly influential in shaping the global network of international double taxation treaties, particularly (but by no means restricted to) the numerous bilateral treaties concluded between OECD member states. *See generally* DAVID DAVIES, PRINCIPLES OF INTERNATIONAL DOUBLE TAXATION RELIEF 39 (1985) ("On a general level, the value of model tax treaties is that they help to harmonize national approaches to double tax relief, while in relation to particular cases they may point the way towards feasible approaches to the resolution of the issues involved that both potential contracting parties are likely to find acceptable" (citing UNITED NATIONS, MODEL DOUBLE TAXATION CONVENTION BETWEEN DEVELOPED AND DEVELOPING COUNTRIES (1980), ST/ESA/102 11)). There is a wide body of literature examining the influence of the OECD Model Double Taxation Convention. Standard texts include PHILIP BAKER, DOUBLE TAXATION CONVENTIONS AND INTERNATIONAL TAX LAW 69-70 (2d ed. 1994) and KLAUS VOGEL, KLAUS VOGEL ON DOUBLE TAXATION CONVENTIONS 3-4 (2d ed. 1991).

[19] *See* Li Jinyan, *China's Tax Treaties and Their Impact on Foreign Investment*, 10 TAX NOTES INT'L 1891 (1995); Wang (Todd) Hongtao, *International Tax Treaties—A Factor to Be Considered by Investors in the PRC*, 16 TAX NOTES INT'L 53 (1998).

addressed first. Rather than elaborate in great detail upon each provision, as such analysis is more than adequately covered by the OECD Commentary,[20] this Article sets out several common fact scenarios, termed "hypotheticals."[21] These hypotheticals illustrate the operation of the main provisions of the Arrangement and also highlight the major omissions and continuing problems of double taxation.

A. Provisions Included in the Arrangement

Article 1: Business profits/permanent establishment. This key provision essentially states that the profits of a Hong Kong enterprise shall be taxable only in Hong Kong unless the enterprise carries on business in the Mainland through a permanent establishment. In this event, the profits of that enterprise may also be taxed by the Mainland but only to the extent attributable to that permanent establishment.

The term "permanent establishment" is defined in the Arrangement. It does not cover facilities or a fixed place of business for storing, displaying or delivering goods, purchasing goods, advertising, collecting information, or conducting other preparatory or ancillary activities. Moreover, projects or supervisory activities carried out, or services furnished by, a Hong Kong enterprise in the Mainland do not constitute a permanent establishment on the Mainland if the projects, activities, or services furnished continue for a period not exceeding six months in any twelve-month period.

Article 2: Shipping, aviation, and land transport. Income from shipping, aviation, and land transport operations carried out by Hong Kong enterprises on the Mainland is exempt from Mainland income tax and, exceptionally for the purposes of the Arrangement, business tax.

Article 3: Personal services. Generally, income derived by a Hong Kong resident providing services on the Mainland, including both employment and independent professional services, will not be subject to individual income tax in the Mainland if that resident does not stay on the Mainland for a period exceeding 183 days in the relevant calendar year.

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[20] COMMITTEE ON FISCAL AFFAIRS, ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, MODEL DOUBLE TAX CONVENTION ON INCOME AND ON CAPITAL (1997).

[21] I am grateful to Simone Yew of Baker & McKenzie, Solicitors, Hong Kong, for suggesting the hypotheticals used in this Article. Another hypothetical involving service providers is discussed in Alfred Choi & Oscar Lau, *PRC Tax Implications for Hong Kong Service Companies Operating in the Mainland*, ASIA-PAC. J. TAX'N, Summer 1998, at 50.

Article 4: Eliminating double taxation. In the areas covered by the Arrangement, Hong Kong will provide tax credit relief for Hong Kong residents who suffer double taxation in the Mainland.

Article 5: Consultation to avoid difficulties. The tax authorities of the two sides may resolve by consultation any difficulties arising from the interpretation or application of the Arrangement, and they may address other problems to eliminate double taxation not covered in the Arrangement.

Articles 6 and 7: Personal scope, taxes covered, and definitions. General definitions, including the crucial concept of resident, are provided and the taxation laws subject to the Arrangement are specified.[22]

B. *Features in a Typical OECD-Type Agreement Missing from the Arrangement*

As stated above, the Arrangement essentially takes the form of a truncated treaty. Although it includes many key provisions, many standard provisions found in the OECD Model Double Taxation Convention are missing from the Arrangement.

Withholding taxes. The source country usually reduces withholding taxes on interest, dividends, and royalties, unless the taxpayer has a permanent establishment in the source county. As indicated above, this issue is simply not dealt with in the Arrangement. The absence of a dividend provision might be explained by the fact that currently, Hong Kong does not levy any withholding tax on dividends and the Mainland does not impose its withholding tax on dividends attributable to foreign equity participation in a foreign-invested enterprise.[23] However, although Hong Kong does not levy any interest withholding tax and only levies a nominal withholding tax on

[22] The existing taxes to which the Arrangement applies in the Mainland are the individual income tax, foreign investment enterprises income tax, foreign enterprises income tax and, in relation to shipping, aviation and land transport operations carried out in the Mainland by Hong Kong enterprises, the business tax. The existing taxes to which the Arrangement applies in Hong Kong are the profits tax, salaries tax, and tax charged under personal assessment. Arrangement, *supra* note 8, art. 6, para. 2.

[23] Guojia Shuiwu Zongju Guanyu Waishang Touzi Qiye, Waiguo Qiye, he Waiji Geren Qude Gupiao (Guquan) Zhuanrang Shouyi he Guxi Suode Shuishou Wenti de Tongzhi [Notice of the State Administration of Taxation Concerning Taxation of Income from Stock (Share Right) Transactions and Dividends Received by Foreign Investment Enterprises, Foreign Enterprises, and Foreign Nationals] Guo Shui Fa (1993) No. 45 (issued July 21, 1993) para. 2, *reprinted and translated in* CHINA L. FOR FOREIGN BUS. (CCH Austl. Ltd.) ¶ 32-706(2) (1994) [hereinafter CHINA L. FOR FOREIGN BUS.].

royalties,[24] the Mainland imposes withholding tax on these income items at the rate of twenty percent.[25]

Income from the alienation of immovable property and capital gains generally. Again, in the absence of a permanent establishment, these items are typically subjected to withholding tax. They are not dealt with by any provision in the Arrangement.

Pensions, income of students and government employees, and "other income." Standard OECD provisions dealing with these matters are not included in the Arrangement.

Associated enterprises. This common provision, which relates to transfer pricing, has been omitted notwithstanding that it is the subject of detailed attention in Mainland laws.

Rules for calculating the profits of a permanent establishment. Article 1, Paragraph 1 of the Arrangement states that the host country can exercise taxing jurisdiction over an enterprise of the other side that is carrying on business through a permanent establishment in the host country, but only to the extent of profits "attributable to that permanent establishment." No rules are laid down for calculating those profits.

Exchange of information. In order to enjoy benefits under the Arrangement, it seems inevitable that certain tax administration procedures will need to be established. Although Article 5 provides that the tax authorities of the two sides may resolve by consultation any difficulties arising from the interpretation or application of the Arrangement, the lack of any formal mechanism for the exchange of information is a significant omission from the Arrangement. It can be assumed, therefore, that the secrecy provisions contained in Section 4 of the Inland Revenue Ordinance ("IRO") have not been affected.[26] Accordingly, with very limited statutory exceptions, it is an offense for staff of the Hong Kong Inland Revenue Department, except in the performance of their duties, to provide any information or access to

[24] *See* CAP 112, Inland Revenue Ordinance §§ 15(1)(a)-(b), 21A, *available in* Inland Revenue Department Homepage (visited Feb. 3, 2000) <http://www.info.gov.hk/ird/index.htm> [hereinafter IRO].

[25] *See* Zhonghua Renmin Gongheguo Waishang Touzi Qiye he Waiguo Qiye Suodeshuifa [Income Tax Law of the People's Republic of China for Enterprises with Foreign Investment and Foreign Enterprises] (adopted Apr. 9, 1991) art. 19 [hereinafter Foreign Investment Enterprise Income Tax Law], *reprinted and translated as* PRC, Foreign Investment Enterprise and Foreign Enterprise Income Tax Law, *in* 3 CHINA L. REFERENCE SERVICE (Asia L. & Practice) Ref. No. 3210/91.06.30 (1997) [hereinafter 3 CHINA L. REFERENCE]. The 20% rate is, however, reduced in a myriad of circumstances. *See, e.g., id.* art. 19(4); Zhonghua Renmin Gongheguo Waishang Touzi Qiye he Waiguo Qiye Suodeshuifa Shishi Xize [PRC, Foreign Investment Enterprise and Foreign Enterprise Income Tax Law Implementing Rules] (adopted June 30, 1991) art. 66 [hereinafter Foreign Investment Enterprise Income Tax Law Implementing Rules], *reprinted and translated in* 3 CHINA L. REFERENCE, *supra*, Ref. No. 3210/91.06.30.

[26] IRO, *supra* note 24, § 4.

records to another party, including the State Administration of Taxation in the Mainland.[27]

Non-discrimination. Standard OECD provisions dealing with non-discrimination are not included in the Arrangement. These provisions are intended to prevent one state from imposing discriminatory taxes on the nationals or businesses of the other state.[28]

C. *Hypotheticals Illustrating the Application of the Arrangement*

The following hypotheticals illustrate the operation of the main provisions of the Arrangement. They are intended to highlight major omissions and any continuing problems of double taxation.

1. *Hypothetical #1—Salaries Tax/Individual Income Tax*

a. *Facts*

Mr. Chan and Ms. Wong are permanent residents of Hong Kong. They are employed by HK Co., a company incorporated in Hong Kong. HK Co. pays their salaries directly into their Hong Kong bank accounts. At the commencement of the calendar year (YR0), Mr. Chan is posted to HK Co.'s representative office in the Mainland for eighteen months. During this year, Ms. Wong travels to the Mainland for a total of 120 days to undertake quality control work for HK Co. in various Mainland factories.

b. *Issues*

How, if at all, does the Arrangement affect Mr. Chan and Ms. Wong? Are there any ongoing problems of double taxation of employment income?

c. *Analysis*

A threshold problem is whether either individual is a "resident" of Hong Kong for the purposes of Article 6, Paragraph 1(1) of the Arrangement, which provides:

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[27] *See also* DIPN No. 32, *supra* note 8, ¶¶ 56-60.

[28] *See generally* DAVIES, *supra* note 18, at 201-06; VOGEL, *supra* note 18, at 1273-1338.

> This Arrangement shall apply to a person who is resident of One Side or a resident of both Sides. The term 'resident' means any person who is liable to tax of One Side by reason of his residence, domicile, place of effective management, place of head office or any other criterion of a similar nature in accordance with the laws of the respective Sides.[29]

On first reading, there is an immediate difficulty in interpreting this article in the Hong Kong context with respect to individuals. Specifically, Hong Kong does not tax income on the basis of residence or domicile or any criterion of a similar nature. Rather, under Section 8(1) of the IRO, income from employment (or an office or pension) is only subject to salaries tax to the extent that it arises in or is derived from a *source* in Hong Kong. Several commentators have thus suggested that the IRO should be amended to deal with this problem.[30]

However, given that (1) it is necessary to give the Arrangement a purposive construction, (2) both sides clearly intend to benefit those residents of either side with potential tax liability on both sides (the very existence of the Arrangement makes this self-evident), and (3) the IRO contains definitions of both "permanent resident" and "temporary resident" in Section 41(4) (albeit relating only to personal assessment taxation), it is reasonable to look at ordinary concepts of residence to give effect to the wording of Article 6. This view is shared by the Hong Kong Inland Revenue Department, which states:

> An individual is considered to be a resident of Hong Kong if he is liable to tax in Hong Kong and he is:
>
> 1. of or above the age of 18 years, or under that age if both parents are deceased; and
>
> 2. a permanent or temporary resident.

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[29] Arrangement, *supra* note 8, art. 6, para. 1(1).

[30] For instance, Archie Parnell of Goldman, Sachs & Co. and Jeff VanderWolk of Deloitte Touche Tohmatsu have both suggested that a new definition of "resident" should be included in the IRO for the express purpose of applying only to any double taxation arrangements or agreements entered into by Hong Kong. Submissions to Hong Kong's Joint Liaison Committee on Taxation (Mar. 1998) (on file with author).

> Reflecting existing definitions in the IRO, it is accepted that in this context a "permanent resident" means an individual who ordinarily resides in Hong Kong. A "temporary resident" means an individual who stays in Hong Kong for a period or a number of periods amounting to more than 180 days in the year of assessment or for a period or periods amounting to more than 300 days in two consecutive years of assessment. . . . It is generally considered that an individual "ordinarily resides" in Hong Kong if he has a permanent home in Hong Kong where he or his family lives.[31]

Assuming that both Mr. Chan and Ms. Wong, as permanent residents of Hong Kong, are considered "residents" of Hong Kong for the purpose of the Arrangement, the question arises as to whether the Arrangement affects them and whether, in any event, there are any outstanding problems of double taxation of employment income.

Since Mr. Chan has been residing in the Mainland for more than one year, he is considered a resident of the Mainland for domestic tax purposes and is thus liable for individual income tax on his employment income on a worldwide basis.[32] Because he has a permanent home in Hong Kong, however, under Article 6, Paragraph 1(2)(i) of the Arrangement he is a resident of Hong Kong. Applying Article 3, Paragraph 2(2) of the Arrangement to these facts, the Mainland clearly has jurisdiction to tax, as Mr. Chan has resided there for a period exceeding 183 days in the calendar year.

Turning now to his tax position in Hong Kong, although Mr. Chan has a Hong Kong-based employer, and is thus potentially liable for Hong Kong salaries tax under IRO Section 8(1), he will nonetheless fall under the IRO Section 8(1A)(c) exemption from salaries tax. This section provides an exemption for income attributed to services rendered in the Mainland and which is subject to individual income tax in the Mainland. Provided Mr. Chan renders no services in Hong Kong, or performs services during visits to Hong Kong not exceeding sixty days during the year,[33] he is not liable for Hong Kong salaries tax and the Arrangement does not apply to him.

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[31] *See* DIPN No. 32, *supra* note 8, ¶¶ 63-64. The procedures adopted by the Mainland for identifying residence in Hong Kong for the purposes of the Arrangement are set out in 1998 Mainland Tax Notice No. 381, *supra* note 14, para. 2. *See also* Chan, *supra* note 11.

[32] Zhonghua Renmin Gongheguo Geren Suodeshuifa (Xiuzheng) [Individual Income Tax Law of the People's Republic of China (Revised)] (adopted Sept. 10, 1980, amended Oct. 31, 1993) art. 1 [hereinafter Individual Income Tax Law], *reprinted and translated as* PRC, Individual Income Tax Law (Revised), *in* 3 CHINA L. REFERENCE, *supra* note 25, Ref. No. 3230/93.10.31.

[33] *See* IRO, *supra* note 24, §§ 8(1A)(b)(ii), 8(1B).

Ms. Wong is in a different position, however. Under Mainland law, because she has spent more than ninety days in the Mainland during the year, Ms. Wong is liable for individual income tax on her Mainland-sourced employment income.[34] However, Ms. Wong is exempt from this tax under Article 3, Paragraph 2(2) of the Arrangement because (1) she spends no more than 183 days in aggregate in the Mainland during the calendar year, (2) her remuneration is not paid by or on behalf of a Mainland employer, and (3) her remuneration is not borne by a permanent establishment or fixed place of business that her employer has in the Mainland. Accordingly, under the Arrangement, Ms. Wong is only liable for Hong Kong salaries tax which, incidentally, is imposed at a lower rate than the Mainland's individual income tax.

Although the example of Ms. Wong illustrates the Arrangement's benefits to travelling employees, it would be a brave person who concludes that all double taxation problems for employees have now been solved. To illustrate this conclusion, the facts of the hypothetical need only be changed slightly. For instance, assume now that Mr. Chan, while posted to the Mainland, returned to Hong Kong for seventy days during the calendar year for employment-related visits. Because he is employed in Hong Kong and renders services in Hong Kong, and because the sixty-day *de minimus* rule in IRO Section 8(1B) does not apply to him, he now becomes fully liable for salaries tax. Section 8(1A)(c) still applies to exempt his income attributable to the Mainland services, but it does not apply to exempt his income referable to the services performed during the seventy days spent in Hong Kong. In addition to salaries tax payable in Hong Kong, individual income tax should be paid in the Mainland on *all* his employment income. Mr. Chan's domestic source income derived from his posting at HK Co.'s representative office will not attract any tax credit from the Mainland for the salaries tax paid in Hong Kong.[35]

Under Article 4, Paragraph 2 of the Arrangement, a tax credit in Hong Kong should be allowed for all individual income tax paid in the Mainland that corresponds to the services Mr. Chan performed in Hong Kong. This conclusion, however, is not immediately obvious from the text of that provision, which states:

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[34] Zhonghua Renmin Gongheguo Geren Suodeshuifa Shishi Tiaoli [Individual Income Tax Implementing Rules of the People's Republic of China] (adopted Jan. 28, 1994) art. 7, *reprinted and translated as* PRC, Individual Income Tax Law Implementing Regulations, *in* 4 CHINA L. REFERENCE SERVICE (Asia L. & Practice) Ref. No. 3230/94.01.28 (1997).

[35] Individual Income Tax Law, *supra* note 32, art. 7.

> In the Hong Kong Special Administrative Region, double taxation shall be eliminated as follows: *Subject to the provisions of the taxation laws and regulations of the Hong Kong Special Administrative Region* regarding the allowance of deduction or credit against the Hong Kong Special Administrative Region tax paid in any place other than the Hong Kong Special Administrative Region, where a resident of the Hong Kong Special Administrative Region derives income from the Mainland of China, the amount of tax paid in the Mainland of China in respect of that income in accordance with the provisions of this Arrangement shall be allowed as a credit against the Hong Kong Special Administrative Region tax imposed on that resident.[36]

In short, the interrelationship between specific provisions, such as Section 8(1A)(c) (which exempts income from salaries tax as distinct from providing a tax credit), the tax credit provision in Section 50 of the IRO (which applies generally to Hong Kong's double taxation agreements) and Article 4, Paragraph 2 of the Arrangement, should be clarified and discussed in the Hong Kong Practice Note.[37]

2. Hypothetical #2—Profits Tax/Foreign Enterprises Income Tax

a. Facts

HK Co. manufactures computer equipment and software in Hong Kong. In YR0 HK Co. sold computer equipment to customers in the Mainland on interest bearing credit terms. On one occasion, HK Co. was paid a separate royalty by a customer for the use of custom software developed by HK Co. in Hong Kong. During the year, HK Co. sent two staff members to the Mainland to supervise the installation of certain equipment for an important customer. HK Co. was also paid separately for this installation work, which was completed within three months.

In YR1, HK Co. established a representative office on the Mainland. The representative office had no authority to enter into any contract with its customers and was primarily operated as a liaison office. Apart from liaison activities, the work of the representative office occasionally involved installing

[36] Arrangement, *supra* note 8, art. 4, para. 2 (emphasis added).
[37] *See* DIPN No. 32, *supra* note 8.

equipment for the customers. HK Co. was paid a separate fee for the installation work. During this year, HK Co. continued to receive the royalty payments commenced in YR0.

b. Issue

How, if at all, does the Arrangement affect HK Co. and are its profits taxable in the Mainland (as well as in Hong Kong)? In any event, are there any ongoing problems of double taxation of HK Co.'s business profits?

c. Analysis

As in Hypothetical #1, a threshold question is whether HK Co. is a "resident" of Hong Kong for the purposes of Article 6, Paragraph 1(1) of the Arrangement. Under this provision, the definition of "resident" is not dependent upon the place of incorporation. Rather, according to the traditional common law test, it depends on where the central management and control of the corporation resides.[38] Assuming that central management and control of the company resides in Hong Kong, HK Co. is a resident of Hong Kong under the Arrangement.

In YR0, HK Co. does not have a "permanent establishment" in the Mainland because the installation project was completed within a period not exceeding six months.[39] Therefore, profits derived from the sale of the equipment and the installation fee should not be subject to income tax in the Mainland.[40] Only the former, being Hong Kong-sourced profits, would be subject to Hong Kong profits tax.

The interest component payable on the sale price of the equipment and the royalty paid for the use of the software would, however, attract withholding tax in the Mainland. The general rate, which is subject to reduction in many cases, is twenty percent.[41] The royalty would also be

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[38] *See* De Beers Consol. Mines Ltd. v. Howe, 1906 App. Cas. 455. The place where the Board of Directors meets to decide the business of the company is usually the controlling factor in determining residence. *Compare* DIPN No. 32, *supra* note 8, ¶¶ 65-74. For the purposes of the Arrangement, the Mainland's State Administration of Taxation may require a certification of residence status from Hong Kong's Inland Revenue Department. *See* 1998 Mainland Tax Notice No. 381, *supra* note 14, annex (detailing the information required to issue a certificate, together with pro forma certificates).

[39] *See* Arrangement, *supra* note 8, art. 1, para. 4(1) (containing the exemption to the definition of permanent establishment).

[40] Customs duty and import value added tax would, however, be levied upon import of the equipment and business tax would be payable on the installation fee. Even if the Arrangement applied to HK Co., none of these duties is covered by the Arrangement.

[41] Foreign Investment Enterprise Income Tax Law, *supra* note 25, art. 19.

subject to business tax at the rate of five percent.[42] The interest (which forms an integral part of the trading transaction carried out in Hong Kong)[43] and, arguably, the royalty, would also be subject to Hong Kong profits tax.[44]

In summary, under the Arrangement, HK Co. obtains permanent establishment protection in YR0. Although HK Co. is still liable for withholding tax (as well as the indirect taxes referred to above) in the Mainland, withholding tax is not covered by the Arrangement. Therefore, tax relief is limited to obtaining a deduction under IRO Section 16(1) for the withholding tax (and indirect taxes) paid, as distinct from a tax credit, to the extent these payments were incurred in producing HK Co.'s taxable profits.

In YR1, HK Co. has a "permanent establishment" in the Mainland.[45] However, HK Co. will only be subject to income tax in the Mainland on the profits attributable to that permanent establishment.[46] Therefore, because the activities of the representative office on the Mainland are restricted to liaison and installation only, the profits derived from the sale of the equipment, as well as the interest and the royalty payments, should continue to be free of Mainland tax (although they may be subject to customs duty, import value added tax ("VAT"), and business tax in the Mainland). However, in contrast to YR0, in YR1 the profits attributable to the installation services would be subject to income tax in the Mainland.[47] The Hong Kong profits tax analysis for YR1 is the same as that for YR0.

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[42] Guojia Shuiwu Zongju Guanyu Waiguo Qiye Xiang Jingnei Zhuanrang Wuxing Zichan Wude Shouru Zhengshou Yingyeshui Wenti de Tongzhi [Notice of the State Administration of Taxation on the Collection of Business Tax Obtained by Foreign Enterprises from the Transfer of Intangible Assets to China] Guo Shui Fa (1998) No. 4 (issued Jan. 13, 1998), *reprinted in* China Infobank, *supra* note 14. An interesting and apparently unresolved question relating specifically to the U.S./PRC tax treaty (but applicable generally to many other Chinese tax treaties), is whether business tax as applied to royalties paid to a U.S. resident without a permanent establishment in the Mainland is indistinguishable from an income tax and therefore prohibited by the treaty. Reportedly, the Mainland government takes the view that business tax is not in the nature of an income tax and is therefore beyond the scope of its treaties. *See* Daniel M. Berman, *Berman Weighs in on Chinese Business Tax*, 17 TAX NOTES INT'L 823 (1998). In the context of the Arrangement, however, it is clear that business tax is not covered by Article 6, Paragraph 2(1) (it is not a tax specified in this provision) and, in terms of Article 6, Paragraph 3, it is not a substantially similar tax imposed after the date the Arrangement took effect (the business tax became effective on January 1, 1994, more than four years before the Arrangement took effect). Arrangement, *supra* note 8, art. 6, para. 2(1), (3). *See generally* Li Jinyan, *PRC Business Tax May Not Be Income Tax for Tax Treaty Purposes*, 17 TAX NOTES INT'L 794 (1998).

[43] *See* IRO, *supra* note 24, § 15(1)(f).

[44] *See* CIR v. HK-TVB Int'l Ltd., [1992] 2 App. Cas. 397.

[45] *See* Arrangement, *supra* note 8, art. 1, para. 1(1). The exemptions (or permanent establishment protection) set out in Article 1, Paragraph 1(5) are not applicable. *Id.* art. 1, para. 1(5).

[46] *See id.* art. 1, para. 1(1).

[47] Specifically, the Foreign Investment Enterprise Income Tax Law applies to such profits. *See* Foreign Investment Enterprise Income Tax Law, *supra* note 25. Additionally, the representative office would be liable for business tax.

As indicated previously, the Arrangement is silent on its application to withholding taxes both on gross income (dividends, interest, and royalties) and net income (rent and capital gains). To help understand why the Arrangement does not apply to these items,[48] it may be useful to state the contrary argument. Under Article 1 of the Arrangement, the profits of a Hong Kong enterprise are *only* taxable in Hong Kong unless that enterprise carries on business in the Mainland through a permanent establishment, in which case the profits attributable to that permanent establishment can be taxed in the Mainland.[49] Article 6, Paragraph 2(1) states that the Arrangement applies to taxes imposed by the Foreign Investment Enterprise Income Tax Law.[50] It is this law which imposes withholding taxes on items such as royalties and interest, as well as on capital gains and rent.[51] Therefore, it can be argued that the Mainland has no jurisdiction to tax HK Co. under the Foreign Investment Enterprise Income Tax Law unless HK Co. has a permanent establishment on the Mainland. Even if HK Co. does have a permanent establishment, the Mainland may tax HK Co. only to the extent that its profits are attributable to the permanent establishment.

However, it is clear that the argument described above ignores the intent of both sides that the Arrangement not apply to withholding taxes.[52] In this regard, it is noteworthy that the Mainland State Council is currently considering what has become the contentious issue of taxing interest income in the Mainland,[53] particularly in relation to interbank and intrabank transactions. It is not surprising, therefore, that taxation of interest payments, which are typically subject to withholding tax, is not covered by this Arrangement. Indeed, the Arrangement is silent on the issue of withholding taxes generally.

One additional argument can bolster the conclusion that jurisdiction to tax royalties, interest, and other passive items such as rent is not governed by the Arrangement. These items arguably constitute receipts of income rather than profits. On this basis, Article 1, Paragraph 1, which speaks solely of

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[48] In this context, it is assumed that the recipient of the relevant income does not have a permanent establishment in the Mainland to which the income could be attributed.

[49] It will be recalled that the above analysis concluded that in YR0, HK Co. did not have a permanent establishment in the Mainland and in YR1, although it had a permanent establishment, the interest and royalty income were not attributable to that establishment. *See* Arrangement, *supra* note 8, art. 1.

[50] *See id.* art. 5, para. 2(1).

[51] *See* Foreign Investment Enterprise Income Tax Law, *supra* note 25, art. 19.

[52] *See* DIPN No. 32, *supra* note 8, ¶ 25; 1998 Mainland Tax Notice No. 381, *supra* note 14, para. 6 (both stating that the treatment of these passive items of income are yet to be resolved and are simply not covered by the Arrangement).

[53] *See also* John Kuzmik & William Thomson, *Chinese Tax Notices Threaten to Increase Foreign Debt Costs*, 16 TAX NOTES INT'L 880 (1998).

"profits," does not restrict the jurisdiction of the Mainland in imposing withholding tax on items of income that are not attributable to a permanent establishment of HK Co. on the Mainland.[54]

3. *Hypothetical #3—Withholding Tax on Rent and Capital Gains*

a. *Facts*

HK Co. owns and leases two office units in the Mainland. It purchased the units from a developer. The units are held solely for the purpose of deriving rental income. During YR0, HK Co. derives a profit from the sale of one of the units to its lessee. It has no other presence in the Mainland and derives no other Mainland-sourced income.

b. *Issue*

How, if at all, does the Arrangement affect HK Co. and is its rental income and capital gain on the sale of the units taxable in the Mainland? In any event, are there any ongoing problems of double taxation of HK Co.'s business profits?

c. *Analysis*

On the basis of the facts above, HK Co. has no permanent establishment in the Mainland. However, under the Foreign Investment Enterprise Income Tax Law, rental income and capital gains from the disposal of property which are derived from a source in the Mainland are liable to withholding tax.[55] Since withholding taxes are not covered specifically by the Arrangement and relate to matters of income (as distinct from profits), the Arrangement does not apply to HK Co.[56] In any event, the rental income and gain upon sale, being sourced outside Hong Kong with the latter also being of a capital nature, would not be subject to Hong Kong profits tax.[57]

[54] *Compare* DIPN No. 32, *supra* note 8, ¶ 26 *and* 1998 Mainland Tax Notice No. 381, *supra* note 14, ¶ 6.

[55] Foreign Investment Enterprise Income Tax Law, *supra* note 25, art. 19; Foreign Investment Enterprise Income Tax Law Implementing Rules, *supra* note 25, art. 61. The transaction giving rise to the gain on sale of the unit would also be liable to various other taxes in the Mainland, including the land value added tax, stamp tax, and deed tax.

[56] *Cf.* analysis of Hypothetical #2.

[57] *See* IRO, *supra* note 24, § 14(1).

D. Outstanding Issues

Many of the uncertain and contentious issues related to the Arrangement have been discussed in the analysis above. For ease of reference, they are collated as follows:

1. The Concept of Residence

The question of who is a "resident" of Hong Kong under the definition contained in Article 6 is discussed in Hypotheticals #1 and #2. The issue concerns both individuals and corporations, given that Hong Kong does not tax income or profits on the basis of residence, domicile, or any criterion of a similar nature.[58]

2. Application of the Arrangement to Withholding Taxes

This issue is discussed in Hypotheticals #2 and #3, in which the conclusion is reached that the Arrangement does not apply to withholding taxes either on gross income (dividends, interest, and royalties) or net income (rent and capital gains). Eventually, the Arrangement may be amended to cover withholding tax. If and when this occurs, there seems to be no reason why the Mainland should not favorably consider a proposal that the rate of any withholding tax levied by it should not exceed the rate provided in other double tax agreements it has entered into.[59]

3. Departmental Interpretation

Hong Kong's Inland Revenue Department and the Mainland's State Administration of Taxation issued the Hong Kong Practice Note and Mainland Notice,[60] respectively, that were finalized just prior to July 1, 1998. These documents set out the respective interpretation and practice of both sides regarding the Arrangement. Although not stated explicitly, it seems a fair assumption that each document was published with the tacit approval of the

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[58] *See supra* notes 31, 38 and accompanying text.

[59] *See generally* Agnes Sin, *Avoiding Double Taxation*, COMPANY SECRETARY, July 1998, at 30. The basic rate of withholding tax is 20%. Foreign Investment Enterprise Income Tax Law, *supra* note 25, art. 19. Under any revised arrangement between the Mainland and Hong Kong, a possible benchmark may be the seven percent rate of interest withholding tax set out in the PRC/Singapore double tax agreement.

[60] *See supra* notes 16-17 and accompanying text.

other side. Apart from covering various matters referred to above, the Hong Kong Practice Note and the Mainland Notice clarify other issues, including how processing, assembly, and contract manufacturing operations conducted in the Mainland will be taxed under the Arrangement[61] and how the tax credit provision in the Arrangement will operate.[62]

4. *Representative Offices*

The taxation of representative or liaison offices established in the Mainland is also discussed in Hypothetical #2. In its comment on Article 1, Paragraph 5(5) of the Arrangement (which provides for permanent establishment protection), Paragraph 23 of the Hong Kong Practice Note states that if a representative office only carries out activities of a preparatory or auxiliary character for the enterprise itself, those activities do not directly generate profits, and the function of the place of business is only of a supportive nature, then the office is not regarded as a permanent establishment of the enterprise in the Mainland.[63] However, Paragraph 23 goes on to state that a fixed place of business that conducts certain "supervisory management functions" for the enterprise or manages certain business operations is regarded as a permanent establishment.[64] The term "supervisory management functions" is not elaborated upon in the Hong Kong Practice Note. Given the increasingly strict view taken by the Mainland's State Administration of Taxation in granting income tax exemptions to representative offices generally,[65] it can be anticipated that the question of whether representative

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[61] Currently, where a Hong Kong resident manufacturer carries on manufacturing activities both in Hong Kong and in the Mainland, (1) only 50% of the profits are taxed in Hong Kong, and (2) generally, on the basis that the activity amounts to a processing or assembly operation, the profits are not subject to tax in the Mainland. This concessional practice should not be affected by the Arrangement and it is not the present intention of the Mainland to change the way it taxes profits derived from this kind of operation. DIPN No. 32, *supra* note 8, ¶ 6. Paragraph 48 goes on to state that no tax credit will be allowed in this case because the question of double taxation does not arise. *Id.* ¶ 48.

[62] *See infra* Part IV. *See also* DIPN No. 32, *supra* note 8, ¶¶ 47-55; 1998 Mainland Tax Notice No. 381, *supra* note 14, para. 6.

[63] DIPN No. 32, *supra* note 8, ¶ 23.

[64] *Id.*

[65] *See* Guojia Shuiwu Zongju Guanyu Waiguo Qiye Changzhu Daibiao Jigou Nashui Jiancha Wenti de Tongzhi [Notice of the State Taxation Administration of Taxation on Issues Concerning Taxation Inspections of Foreign Enterprise Resident Representative Offices] Guo Shui Fa (1996) No. 106 (issued June 12, 1996), *reprinted and translated in* [Taxation & Customs] CHINA L. FOR FOREIGN BUS., *supra* note 23, ¶ 32-669(1); Guojia Shuiwu Zongju Guanyu Jiaqiang Waiguo Qiye Changzhu Daibiao Jigou Shuishou Zhengying Youguan Wenti De Tongzhi [Notice of the State Administration of Taxation on Issues Concerning Improvement of Taxation Collection Administration for Foreign Enterprise Resident Representative Offices] Guo Shui Fa (1996) No. 165 (issued Sept. 13, 1996), *reprinted and translated in* CHINA L. FOR FOREIGN BUS., *supra* note 23, ¶ 32-671(1); Guojia Shuiwu Zongju Guanyu Waiguo Qiye Changzhu Daibiao Jigou Shuishou Ruogan Juti Wenti de Tongzhi [Notice of the State Administration of

offices of Hong Kong enterprises set up in the Mainland qualify for permanent establishment protection under the Arrangement will continue to be contentious.

III. THE FOREIGN DIMENSION

An additional dimension of the Arrangement is that it applies to a Hong Kong branch of a foreign corporation, provided the corporation is centrally managed and controlled in Hong Kong.[66] This matter will be very important in the Hong Kong context because many listed as well as private corporations controlled by Hong Kong residents, but incorporated outside Hong Kong, carry on business both in Hong Kong and in the Mainland. Conversely, a Hong Kong corporation resident overseas in the sense described above is not a Hong Kong resident and the Arrangement does not apply to it.

One final query is whether there is room for so-called "treaty shopping" under the Arrangement. The answer would appear to be that this is possible. At present, however, it is not likely, because the Arrangement is limited in scope (for instance, it is inapplicable to withholding taxes on passive income, including capital gains). Also, the Arrangement is by no means as beneficial as other treaties entered into by the People's Republic of China ("PRC"). For example, the PRC treaty with Mauritius is one of the few PRC treaties providing a significant level of capital gains tax protection.[67]

IV. TAX CREDIT PROCEDURES IN HONG KONG

Under Article 4 of the Arrangement, when a Hong Kong resident is subject to taxation in the Mainland and in Hong Kong, Hong Kong is required to give a credit for taxes paid on the relevant income in the Mainland. This provision relates to IRO Section 50, which contains the general rules for double tax relief in Hong Kong.[68] Under Section 50, any income tax payable in the Mainland by a Hong Kong resident under the Arrangement can be credited against tax payable on that income in Hong

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Taxation on Certain Detailed Issues Concerning Tax Levies on Foreign Enterprise Resident Representative Offices] Guo Shui Fa (1997) No. 2 (issued Jan. 2, 1997), *reprinted and translated in* CHINA L. FOR FOREIGN BUS., *supra* note 23, ¶ 32-762(2).

[66] *See* DIPN No. 32, *supra* note 8, ¶ 65.

[67] *See* Agreement Between the Government of the People's Republic of China and the Government of the Republic of Mauritius for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, art. 13, *reprinted in* GOVERNMENT GAZETTE OF MAURITIUS (Sept. 3, 1994) No. 98.

[68] *See* IRO, *supra* note 24, §50.

Kong, but only to the extent of the Hong Kong tax payable.[69] Thus, if a Hong Kong resident incurs a loss in a year of assessment and does not pay tax in Hong Kong, tax paid by it in the Mainland will not be allowed as a credit.[70]

It is not immediately clear how Article 4 of the Arrangement and IRO Section 50 will operate in the face of other, very limited, double tax relief provisions contained in the IRO, such as those found in Sections 8(1A)(c) and 16(1) and (1)(c).[71] Thus, it would be very useful for the Inland Revenue Department to indicate how double tax relief will actually operate in cases where domestic statutory relief also applies.[72] The general example of HK Co. selling products in the Mainland with the marketing and networking assistance of its Mainland representative office illustrates the broad scope of Article 4. Under current Mainland law and practice, the representative office will be subject to Mainland tax, normally on a deemed profit basis, unless it can obtain tax-exempt status. Such status is becoming increasingly more difficult to obtain.[73] However, unless HK Co. is successful in making a claim that it derived tax-exempt non-Hong Kong profits, its profits from Mainland sales will also be subject to Hong Kong profits tax. In this event, it seems clear from both the Arrangement and IRO Section 50 that a tax credit should be granted by Hong Kong for the Mainland income tax (but not business tax) paid by the representative office.

V. CONCLUSION

The degree of commitment demonstrated by the Mainland in dealing with the issue of double taxation, which until recently was (and may still be) more academic than pressing, should be highly encouraging to Hong Kong's business community.[74] By easing concerns, providing greater certainty, and

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[69] *See* 1998 Mainland Tax Notice No. 381, *supra* note 14, para. 4 (discussing the converse case of a Mainland resident obtaining a tax credit under Article 4 of the Arrangement for taxes paid in Hong Kong).

[70] *See* DIPN No. 32, *supra* note 8, ¶ 52.

[71] These provisions are discussed in Hypotheticals #1 and #2, respectively.

[72] *See* DIPN No. 32, *supra* note 8, ¶¶ 48-55. The examples given in these paragraphs do not address these issues.

[73] *See supra* note 65 and accompanying text.

[74] The Deputy Secretary for the Treasury, addressing a Provisional Legislative Council Subcommittee, has been quoted as saying, "In the long term, the benefits are inestimable for Hong Kong companies." Duncan Hughes, *Government Sees 'Inestimable Benefits' from Mainland Deal*, S. CHINA MORNING POST, Mar. 17, 1998, at 2. *See also*, *One Country, Two Tax Systems*, HONG KONG ACCT., July-Aug. 1998, at 81. One year after the resumption of sovereignty, the Inland Revenue Department reflects on the concept of "one country, two systems" and how it has been put into practice. *Id.*; *see also A Day in the Life (of the Commissioner of Inland Revenue)*, HONG KONG ACCT., Nov.-Dec. 1998, at 24. The former Commissioner, Wong Ho-sang, states that in his view the main benefits to Hong Kong arising from the

lowering the tax liability of Hong Kong residents working on the Mainland and Hong Kong enterprises operating on the Mainland, the Arrangement helps to establish a firm foundation for future co-operation between the Mainland and Hong Kong on trade and other economic matters. From a Hong Kong taxation perspective, it is one of the most significant developments to have occurred for a very long time. From a broader perspective, the Mainland has adopted a flexible and innovative approach to taxation issues related to Hong Kong—a standard treaty template has been used to regulate jurisdiction to tax within different parts of the People's Republic of China. This augurs well for the effective implementation of the autonomy promised to Hong Kong under the challenging rubric of "one country, two systems."

Arrangement are (1) permanent establishment protection for Hong Kong representative offices in the Mainland; (2) the promotion of the attractiveness of Hong Kong to Mainland businesses in areas such as direct sales and distribution; (3) the enhancement of Hong Kong's potential to become an infrastructure co-ordination center for the Mainland; (4) the enhancement of Hong Kong's potential to become a marine, land and air transport center for the Mainland; (5) the promotion of Hong Kong as a springboard for multinational corporations wishing to enter the China market; and (6) fulfillment of the promise that Hong Kong will continue to operate under the concept of "one country, two (tax) systems." *Id.*