

Hong Kong SAR will soon implement the OECD Multilateral Instrument to modify tax treaties

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Issue 14

In brief

To give effect to the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*¹ (Multilateral Instrument or MLI) in Hong Kong SAR, an order was gazetted on 30 September 2022 and tabled at the Legislative Council (LegCo) on 19 October 2022 for negative vetting.

Hong Kong SAR has listed 39 comprehensive double taxation agreements (CDTAs) as treaties covered by the MLI (Covered Tax Agreements). The provisions of the MLI will have effect in Hong Kong SAR on 1 April 2023 (for taxes withheld at source) or 1 April 2024 (for other taxes) at the earliest.

In detail

Background

The MLI was developed by the Organisation for Economic Co-operation and Development (OECD). It enables jurisdictions to effectively implement the tax treaty-related minimum standards of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project without the need to amend tax treaties bilaterally. As of 6 October 2022, 100 jurisdictions have signed the MLI².

Mainland China became a signatory to the MLI on 7 June 2017 and deposited the instrument of approval of the MLI with the OECD on 25 May 2022. Having sought the views of the Hong Kong SAR Government, the Central People's Government extended the application of the MLI to Hong Kong SAR.

To give effect to the MLI in Hong Kong SAR, the Inland Revenue (Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting) Order³ (the Order) was gazetted on 30 September 2022 and tabled at the LegCo on 19 October 2022 for negative vetting. The Order will come into operation on 9 December 2022.

The MLI position of Hong Kong SAR

Hong Kong SAR has so far concluded CDTAs with 45 jurisdictions (CDTA Partners), among which 39 CDTAs have been listed by Hong Kong SAR as Covered Tax Agreements. The remaining 6 CDTAs (including CDTAs with Mainland China, Macao SAR, Estonia, Finland, Georgia and Serbia) are excluded as they have already incorporated the relevant BEPS-compliant provisions.

Hong Kong SAR will implement the MLI using the following pragmatic approach⁴:

MLI article	Provisions adopted by Hong Kong SAR
Article 6 – Purpose of a Covered Tax Agreement	<p>Mandatory provision: To include in the preamble of a CDTA an express statement that the common intention of the contracting jurisdictions is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements)</p> <p>Optional provision: To include in a CDTA preamble language referring to a desire to further develop an economic relationship and to enhance cooperation in tax matters</p>
Article 7 – Prevention of Treaty Abuse	<p>Mandatory provision: To prevent treaty abuse by adopting the ‘principal purpose test’ rule</p>
Article 16 – Mutual Agreement Procedure (MAP)	<p>Mandatory provision: To modify the dispute resolution mechanism under MAP</p>

Impact of the MLI⁵

For the 39 CDTAs that have been listed by Hong Kong SAR as Covered Tax Agreements, the MLI status of the CDTA Partners as of 6 October 2022 is as follows:

MLI status of the CDTA Partners	Implications	Number of CDTAs
1. The CDTA Partner has also listed the CDTA with Hong Kong SAR as a Covered Tax Agreement	The CDTA will be modified by the MLI	31
2. The CDTA Partner has not yet deposited the instrument of ratification, acceptance or approval of the MLI with the OECD	The CDTA Partner has not yet given effect to the MLI and the CDTA will not be modified by the MLI for the time being	4 (CDTAs with Italy, Kuwait, Mexico ⁶ and Vietnam)
3. The CDTA Partner has not listed the CDTA with Hong Kong SAR as a Covered Tax Agreement	The CDTA will not be modified by the MLI	1 (CDTA with Switzerland)
4. The CDTA Partner has not signed the MLI	The CDTA will not be modified by the MLI	3 (CDTAs with Belarus, Brunei and Cambodia)
Total		39

The impact of the MLI on the above 31 Covered Tax Agreements that will be modified is summarised below. The extent to which a Covered Tax Agreement will be modified under an MLI article will depend on the matching of the MLI positions of Hong Kong SAR and the CDTA Partner in respect of each specific provision in that article.

MLI article	Number of Covered Tax Agreements that will be modified by the MLI article
Article 6 – Purpose of a Covered Tax Agreement	31
Article 7 – Prevention of Treaty Abuse	30 (except Pakistan which has chosen to apply the Simplified Limitation of Benefits provision instead of the 'principal purpose test' rule)
Article 16 – MAP	21

Effective dates

Subject to the completion of the legislative and other relevant procedures of the MLI by Hong Kong SAR and the CDTA Partners, the provisions of the MLI will have effect in Hong Kong SAR with respect to a Covered Tax Agreement on 1 April 2023 (for taxes withheld at source) or 1 April 2024 (for other taxes) at the earliest.

The takeaway

The MLI enables Hong Kong SAR to effectively modify the existing CDTAs to incorporate BEPS-compliant provisions. It strengthens Hong Kong SAR's commitment to complying with the international tax standards and preventing treaty abuse. It is expected that Hong Kong SAR will continue to play an active role in international tax co-operation, including the implementation of BEPS 2.0 and the refinement of the foreign source income exemption regime.

To facilitate stakeholders' understanding of the impact of the MLI, the Inland Revenue Department (IRD) will publish guidance on its website. It would be helpful if the IRD could also publish MLI-synthesised texts which present the original text of the CDTAs with modifications by the MLI for taxpayers' reference. Taxpayers with cross-border arrangements or international operations should monitor further updates from the IRD and assess the potential impacts brought about by the MLI.

Endnotes

1. The text of the MLI can be accessed via this link:
<https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf>
2. A list of the signatories and parties to the MLI can be accessed via this link:
<https://www.oecd.org/tax/treaties/beps-ml-signatories-and-parties.pdf>
3. The Order can be accessed via this link:
<https://www.gld.gov.hk/egazette/pdf/20222639/es22022639182.pdf>
4. A list of the reservations and notifications made by Hong Kong SAR in respect of the application of the MLI is set out in Schedule 2 to the Order.
5. The statistics in the two tables are prepared based on the data from the MLI Matching Database of the OECD as of 6 October 2022. The database can be accessed via this link:
<https://www.oecd.org/tax/treaties/ml-matching-database.htm>
6. Mexico has ratified the MLI on 12 October 2022 and is expected to deposit the instrument of ratification, acceptance or approval of the MLI with the OECD soon.

Let's talk

For a deeper discussion of how this impacts your business, please contact:

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