

## Hong Kong and Macao sign income tax treaty

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Hong Kong signed, on 25 November 2019, a comprehensive income tax treaty with Macao (the Treaty).

The key provisions of the Treaty are highlighted below.

### Promoting trade and investment

The following table summarizes the applicable withholding rates for passive income when received from Macao by a Hong Kong resident as beneficial owner.<sup>1</sup>

Passive income / Tax rate	Dividends	Interest	Royalties	Capital gains on disposal of shares
Current withholding rate for companies	0%	0%	0%	0%
Withholding rate under the Treaty	0/5%	0/5% <sup>2</sup>	3% <sup>3</sup>	0% <sup>4</sup>

## Avoidance of double taxation

Where the income of a Hong Kong resident is subject to tax in both Hong Kong and Macao, the Hong Kong resident can credit the tax paid in Macao against the Hong Kong tax liability arising on the same income. The available tax credit is, however, limited to the Hong Kong tax imposed on the same income.

## Permanent establishment (PE)

Under the Treaty, a dependent agent who “habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise” will be sufficient to constitute a dependent agency PE.

The Treaty also includes an anti-contract splitting rule and an anti-fragmentation rule.

## Entitlement to benefits

Under the principal purpose test, tax benefits otherwise granted under the Treaty will be denied if it is reasonable to conclude that one of the principal purposes of an arrangement or transaction is to obtain a benefit under the Treaty.

## Effective date of the Treaty

The Treaty will enter into force in the tax year following the calendar year in which the ratification procedures are completed by both jurisdictions. Assuming the ratification procedures are completed in 2019, the Treaty will become effective as follows:

- ▶ Hong Kong: for any year of assessment beginning on or after 1 April 2020
- ▶ Macao: for any fiscal year beginning on or after 1 January 2020

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## Endnotes

1. Hong Kong withholding rate is 0% on dividends, interest, fees for technical services and capital gains; 4.95% on royalties.
2. Dividends received are not taxable in Macao if the dividends are distributed by Macao entities from their after-tax profits in Macao. If Macao levies a withholding tax on dividends or interest in future, the tax so charged will not exceed 5%. Nonetheless, a 0% rate applies if the beneficial owner of the dividends or interest is the Hong Kong SAR Government, the Hong Kong Monetary Authority or the Exchange Fund.
3. If Macao levies a withholding tax on royalties in future, the tax so charged will not exceed 3%.
4. Capital gains on the disposal of shares in a Macao company derived by a Hong Kong resident investor will generally be exempt from tax in Macao. The only exception to this is when the shares being disposed of are in respect of a company holding substantial immovable property located in Macao.

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