

China and Hong Kong sign Fifth Protocol to Treaty

NEW! EY Tax News Update: Global Edition

EY's new Tax News Update: Global Edition is a free, personalized email subscription service that allows you to receive EY Global Tax Alerts, newsletters, events, and thought leadership published across all areas of tax. Access more information about the tool and registration [here](#).

Also available is our [EY Global Tax Alert Library](#) on ey.com.

Executive summary

China¹ and Hong Kong signed the Fifth Protocol (the Protocol) to the current China-Hong Kong Income Tax Treaty (the Treaty) on 19 July 2019. The Protocol will enter into force in the tax year following the calendar year in which the ratification procedures are completed.

Significant provisions in the Protocol include:

- ▶ Tie-breaker rule for a treaty residency determination for non-individual dual resident persons.
- ▶ Clarification on the determination of Dependent Agency Permanent Establishment (Agency PE).
- ▶ Disposal of shares or comparable interests in a Chinese land-rich entity.
- ▶ Principal purpose test (PPT) for entitlement to benefits.

This Alert summarizes the key provisions of the Protocol.

Detailed discussion

Tie-breaker rule for non-individual dual resident persons agreement

When a person other than an individual is a dual resident, the competent authorities of both Contracting States will seek a determination by mutual agreement of the place of residence based on the place of effective management, the place of incorporation or otherwise constituted and any other relevant factors. In the absence of such agreement, the person will not be entitled to any treaty relief unless both competent authorities agree on.

Lower Agency PE threshold

Under the Protocol, in addition to the current provision of “habitually concludes contracts,”² 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 an Agency PE.

Under the Treaty, an agent whose activities are “wholly or almost wholly performed on behalf of an enterprise of a contracting party” will be considered as a dependent agent.

Under the Protocol, an agent will be treated as a dependent agent when the agent acts “exclusively or almost exclusively on behalf of one or more enterprises to which the agent is closely related.”³

Disposal of shares or comparable interests in a Chinese land-rich entity

The Treaty grants China the right to impose tax on a Hong Kong resident who disposes shares in a Chinese “land-rich” company. The Protocol extends China’s taxing rights to comparable interests in other entities such as partnerships and trusts.

However, the definition of a “land-rich” entity is slightly relaxed under the Protocol to “more than 50%” from “50% or more” of the underlying assets of an entity being immovable property situated in China.

Entitlement to benefits

Under the PPT, 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 secure a benefit under the Treaty.

Endnotes

1. The term refers to Mainland China.
2. Currently, the Treaty provides that when a dependent agent of an enterprise of a contracting party who habitually acts on behalf of the enterprise and has, and habitually exercises, an authority to conclude contracts in the name of the enterprise in the other contracting party, that enterprise will be deemed to have an Agency PE in the other contracting party.
3. The term “closely related” is broadly defined in the Protocol as follows: “based on all the relevant facts and circumstances, one [party] has control of the other or both are under the control of the same persons or enterprises...”

For additional information with respect to this Alert, please contact the following:

Ernst & Young Tax Services Limited, Hong Kong

- ▶ David Chan david.chan@hk.ey.com
- ▶ Paul Ho, *Financial Services* paul.ho@hk.ey.com
- ▶ Jane Hui jane.hui@hk.ey.com
- ▶ Becky Lai becky.lai@hk.ey.com

Ernst & Young LLP (United States), China Tax Desk

- ▶ Min Fei, *New York* min.fei@ey.com
- ▶ Vickie Lin, *New York* vickie.lin@ey.com
- ▶ Ryan Lu, *New York* ryan.lu@ey.com
- ▶ Lucy Wang, *Chicago* lucy.wang1@ey.com
- ▶ Diana Wu, *San Jose* diana.wu@ey.com

Ernst & Young LLP (United States), Hong Kong Tax Desk, New York

- ▶ Rex Lo rex.lo1@ey.com

Ernst & Young LLP (United States), Asia Pacific Business Group, New York

- ▶ Chris Finnerty chris.finnerty1@ey.com
- ▶ Kaz Parsch kazuyo.parsch@ey.com
- ▶ Bee-Khun Yap bee-khun.yap@ey.com

About EY

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

© 2019 EYGM Limited.
All Rights Reserved.

EYG no. 003937-19Gbl

1508-1600216 NY
ED None

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.

ey.com