



2 September 2005

By email and by fax (2511 7414)
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Your Ref.: DAD(CR)483/141-14C
Our Ref.: C/TXG, M36608

Inland Revenue Department
36/F, Revenue Tower
5 Gloucester Road
Wanchai
Hong Kong

(For the attention of Mrs. Leung Lam Sau-mei)

Dear Sirs,

Double Taxation Arrangement with the Mainland

We write further to the Institute's submission dated 25 August 2005.

At the Institute's Taxation Interest Group discussion forum held on 16 August 2005 ("TIG discussion forum"), a suggestion was raised to dispense with the 183-day rule for determining the Hong Kong and PRC tax liabilities in relation to remuneration for dependent personal services. In view of the potential revenue implications of the proposal, it was suggested that Hong Kong practitioners should ascertain whether the State Administration of Taxation (SAT) would be receptive to such a proposed change, prior to referring it to the Inland Revenue Department as a possible agenda item for the September 2005 meeting on the Double Taxation Arrangement with the Mainland ("the Arrangement").

--- Under the existing paragraph 2 of Article 3 of the Arrangement, the wording of which is set out in Appendix 1, remuneration derived by a resident of one of the jurisdictions in respect of an employment exercised in the other jurisdiction will be exempt from tax in the other jurisdiction if, amongst other things, the recipient stays in the other jurisdiction for a period or periods not exceeding in the aggregate 183 days in the relevant calendar year. We are given to understand that in practice there are cases of under-reporting or even non-disclosure of taxable income by taxpayers, in respect of Hong Kong salaries tax and PRC individual income tax liabilities. Hong Kong residents working in the Mainland and Mainland residents working in Hong Kong may misinterpret the complex 183-day rule, or sometimes mistakenly rely on it in a way that results in non-compliance.



--- The Institute would suggest doing away with the 183-day rule and simplifying the provisions of paragraph 2 of Article 3, in the manner suggested in Appendix 2, to facilitate enforcement in Hong Kong and the Mainland.

Subsequent to the TIG discussion forum, a senior member of the Institute raised with a senior SAT official in Beijing, the idea of doing away with the 183-day rule. The SAT official appeared to be receptive to the idea and suggested that the Institute should put it forward in writing as a possible agenda item for the September 2005 meeting.

As the proposed change would make it more difficult for taxpayers to evade taxes on their remuneration on either side of the border, the Institute suggests that it should be included for discussion at the September 2005 meeting, as one of the more important items amongst those put forward in the Institute's submission dated 25 August 2005.

We trust that you find our proposal to be constructive. If you have any comments or questions in relation to the above, please feel free to contact our John Tang, Assistant Director, Specialist Practices at johntang@hki CPA.org.hk or at 2287 7006.

Yours faithfully,

A handwritten signature in black ink that reads 'Peter Tisman'. The signature is written in a cursive, flowing style.

Peter Tisman
Director, Specialist Practices

PMT/JT/ay
Encls.

Paragraph 2 of Article 3 of the Double Taxation Arrangement between Hong Kong and the Mainland - Current wording

“2. Dependent personal services

(1) Subject to the provisions of paragraph 3 of this Article, salaries, wages, and other similar remuneration derived by a resident of One Side in respect of an employment shall be taxable only on that Side unless the employment is exercised on the Other Side. If the employment is so exercised, such remuneration as is derived therefrom may be taxed on the Other Side.

(2) Notwithstanding the provisions of sub-paragraph (1) of this paragraph, remuneration derived by a resident of One Side in respect of an employment exercised on the Other Side shall be taxable only on the first-mentioned Side if:

- (i) the recipient stays on that Other Side for a period or periods not exceeding in the aggregate 183 days in the calendar year concerned; and*
- (ii) the remuneration is paid by, or on behalf of, an employer who is not a resident of that Other Side; and*
- (iii) the remuneration is not borne by a permanent establishment or a fixed base which the employer has on that Other Side.”*

Paragraph 2 of Article 3 of the Double Taxation Arrangement between Hong Kong and the Mainland - Proposed wording

“2. Dependent personal services

(1) Subject to the provisions of paragraph 3 of this Article, salaries, wages, and other similar remuneration derived by a resident of One Side in respect of an employment shall be taxable only on that Side unless the employment is exercised on the Other Side. If the employment is so exercised, such remuneration as is derived therefrom may be taxed on the Other Side.

(2) Notwithstanding the provisions of sub-paragraph (1) of this paragraph, remuneration derived by a resident of One Side in respect of an employment exercised on the Other Side shall be taxable only on the first-mentioned Side to the extent that:-

- (i) the remuneration is not borne by a permanent establishment or a fixed base which the employer has on that Other Side or a resident of that Other Side; and*
- (ii) the remuneration is fully chargeable to tax on the first-mentioned Side; and*
- (iii) the resident of the first-mentioned Side is not rendering employment services wholly on that Other Side.”*