THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2026

MODULE 2.04 – HONG KONG OPTION

ADVANCED INTERNATIONAL TAXATION (JURISDICTION)

TIME ALLOWED – 3¼ HOURS

This exam paper has **three** parts: **Part A**, **Part B** and **Part C**.

You need to answer **five** questions in total. You will **not** receive marks for any additional answers.

You must answer:

- **Both** questions in **Part A** (25 marks each)
- **One** question from **Part B** (20 marks)
- **Two** questions from **Part C** (15 marks each)

Further instructions

- All workings should be made in Hong Kong Dollars, unless otherwise stated. Any monetary calculations should be made to the nearest whole Hong Kong Dollar. Any necessary time apportionments in your calculations should be made to the nearest whole month.
- You must provide appropriate line breaks between each question, and clearly indicate the start of each new question using the formatting tools available.
- Marks may be allocated for clarity of presentation of your answers.
- The time you spend answering questions should correspond broadly to the number of marks available for that question. You should therefore aim to spend approximately half of your time answering Part A, and the other half answering questions in Parts B and C.
- There is no separate reading time, so you can start typing your answers as soon as the exam begins. However, we recommend that you set aside some time to thoroughly read each question and plan each of your answers.

For your information this paper includes:

Hong Kong Tax Rates and Allowances

Agreement between Mainland China and Hong Kong for the Avoidance of Double Taxation (Extracts)

PART A

You are required to answer BOTH questions from this Part.

1. Aqua Group Holdings Ltd (AGH) is a United Kingdom-based multinational company and the ultimate holding company of a global retail chain operating under the 'Aqua' brand name. AGH has established several subsidiaries across different jurisdictions to operate retail stores under the Aqua brand. In certain countries, instead of directly operating the stores, AGH or one of its subsidiaries licenses use of the Aqua brand to third parties in exchange for royalty income.

   One of the subsidiaries, Blue Ocean Ltd (BOL), is incorporated in Hong Kong and is wholly owned by AGH. BOL was granted the exclusive right (including sublicensing rights) to use the Aqua brand in Hong Kong and mainland China. The contractual terms were determined at the directors' meetings of AGH in the UK; the license agreement was drafted in the UK. BOL's director signed the agreement in Hong Kong and returned it to AGH via email.

   In exchange for the rights, BOL paid AGH the following:

   a) An upfront lump-sum payment of HK$50 million for the initial assignment of the rights for ten years. 60% of the sum related to the Hong Kong market, with the remaining 40% of the sum relating to overseas markets.

   b) Annual royalties, calculated with reference to BOL's gross revenue, for use of the Aqua brand name itself in Hong Kong and gross royalties from overseas licensees.

   During the year ending 31 December 2025, BOL negotiated and concluded a sublicensing contract with Golden River Trading Ltd (GRT), a company incorporated in mainland China, for use of the Aqua brand in that market. All negotiations, approvals, and contractual execution were handled by BOL's Hong Kong staff at the Hong Kong office via email and online meetings, and the royalties were paid into BOL's Hong Kong bank accounts.

   The following income and expenses were derived or incurred by BOL in connection with the use of the Aqua brand during the year:

Description	$
Trading income from Hong Kong retail stores	10,000,000
Royalty income from sublicensing Aqua to GRT	5,000,000
Annual royalty expense to AGH, for using Aqua in Hong Kong stores	600,000
Annual royalty expense to AGH, for the right to sublicense Aqua to GRT	300,000
Mainland China withholding income tax on royalty income from GRT (7% of HK$5 million)	350,000
Mainland China withholding VAT on royalty income from GRT (6% of HK$5 million)	300,000
Operating expenses for Hong Kong market	2,000,000

   You are required to discuss and compute the tax position of BOL, pertaining to the information provided. Your answers should be supported with appropriate reasoning and reference to relevant case law, principles, and Departmental Interpretation and Practice Notes.

   In your answer, you are required to:

   1) **Analyse the taxability of the royalty income and deductibility of the related expenses, with the exception of the upfront royalty payment.** (12)

   2) **Analyse the taxability of the trading income from Hong Kong stores and deductibility of the related expenses, with the exception of the upfront royalty payment.** (3)

   3) **Analyse the deductibility of the upfront royalty payment.** (5)

   4) **Calculate the tax payable in relation to the royalty income from GRT, assuming the two-tiered tax rate does not apply and ignoring any tax reduction.** (5)

   Total (25)

2. Alpha Consulting Ltd (ACL) is a company incorporated and tax resident in mainland China. It provides consultancy services to corporate clients in Hong Kong. ACL has no subsidiaries in Hong Kong, but regularly undertakes sizeable consultancy projects there for its Hong Kong clients.

Beta Advisory Ltd (BAL) is an independent consultancy firm incorporated and based in Hong Kong and is not related to ACL. In 2025, ACL entered into a master services agreement with a Hong Kong client (the Client) to provide strategic and operational consultancy services for a two-year transformation project in Hong Kong. Under the agreement, ACL is contractually responsible for delivering the services and overall project outcomes to the Client.

To fulfill its contractual obligations, ACL subcontracts a substantial part of the on-site consultancy work to BAL, as an unrelated subcontractor. While BAL's consultants perform most of the project work at the Client's premises in Hong Kong, ACL retains overall responsibility for the project and remains the sole contracting party to the Client.

Under the subcontracting arrangement, BAL performs the agreed consultancy work at the Client's office and project rooms in Hong Kong. These project facilities are made available for the exclusive use of the project team (including BAL's staff and ACL's visiting staff), for the duration of the engagement.

ACL has the right, under the master services agreement and project protocols, to access and use such offices and project rooms whenever needed to carry out the consultancy project, to direct the project schedule, and to control who may enter the project rooms. ACL's project director approves key operational decisions and retains overall responsibility for what happens at those locations. BAL is remunerated by ACL on an arm's length, cost-plus basis.

In addition, ACL sends two mainland China-based senior consultants (both mainland China tax residents) to Hong Kong on a recurring basis to supervise BAL's performance, review project deliverables, and meet with the Client. Each of these consultants travels to Hong Kong once every two weeks and typically spends two full working days in the Client's project rooms during each visit. Their work pattern remains broadly the same throughout 2025 and 2026. When in Hong Kong, they work from the same project rooms used by BAL's consultants and report directly to ACL's management in mainland China.

ACL receives consultancy fees directly from the Client. In determining the accounting profits for the consultancy project in Hong Kong, an appropriate portion of ACL's overall management and administrative expenses and subcontracting payments made to BAL are charged to the project's income and expenditure statement.

You are required to:

1) **Critically analyse whether or not ACL has established a permanent establishment (PE) in Hong Kong in the form of a fixed place of business. You should specifically consider ACL's potential exposure to Hong Kong Profits Tax regarding this engagement.**

   Your answer should be supported with reference to the Inland Revenue Ordinance (IRO), the double taxation agreement (DTA) between mainland China and Hong Kong, the OECD Commentaries on Article 5, relevant case law and practice notes. (13)

2) **Assuming that there is a fixed place PE in Hong Kong for ACL, critically analyse how the profits attributable to the Hong Kong PE should be determined for Hong Kong Profits Tax purposes under the IRO, the China-Hong Kong DTA, and relevant OECD profit attribution principles. In particular, you should discuss the treatment and deductibility of:**

   a) **subcontracting fees paid by ACL to BAL; and**

   b) **an appropriate share of ACL's overall expenses (e.g., management, administration, and support functions).** (12)

Total (25)

PART B

You are required to answer ONE question from this Part.

3. Alpha Manufacturing Ltd (AML), a Hong Kong-incorporated and tax resident company, is engaged in garment manufacturing. In July 2024, AML acquired ten weaving machines at $1 million each. AML put the machines into use during the year ending 31 December 2024 and claimed depreciation allowances thereof.

Bright Horizons Holding Inc. (BHH) was incorporated and is a tax resident of the United States, serving as the immediate holding company of AML. BHH owns 100% of AML's shares. It is engaged in investment holding and providing cross-border financing support to its subsidiaries in various jurisdictions. BHH has been leasing machines in Hong Kong for several years and has incurred losses from this activity.

In January 2025, the management of AML proposed to enter into a sale-and-leaseback arrangement with BHH under which AML would sell all ten weaving machines to BHH for $1,100,000 each, and BHH would then grant AML a right to use the machines for three years in return for lease rentals set at a level 10% higher than the prevailing market leasing rate for comparable machinery.

You are required to explain the Hong Kong Profits Tax implications of the proposed arrangement, in the context of:

1) **Taxability for BHH of the lease rental, deductibility of the weaving machines' acquisition cost, and entitlement to depreciation allowance for the weaving machines.** (10)

2) **The potential risk to AML, under the general anti-avoidance provisions, of the deduction of the lease rental. No discussion of the application of the transfer pricing rule is required.** (10)

Total (20)

4. Strawberry Ltd (SL) carries on business in Hong Kong. Its provisional income statement for the year ending 31 March 2025 shows a net pre-tax profit of $16,900,000, after crediting the following income and charging the following expenses:

Income	Note	$
Interest on RMB sovereign bonds		300,000
Expenditure		
Product research expenses	1	1,500,000
Legal expenses	2	100,000
Bad debts	3	75,000

Explanatory notes

1) The product research expenses of $1,500,000 comprise the following items, which qualify as research activities conducted in Hong Kong:

	$
Research director's remuneration	1,000,000
Research staff salaries	400,000
Payment to a local research institute	100,000
Total per accounts	1,500,000

2) The legal expenses comprise $40,000 for preparing the initial tenancy agreement for the company's office and $60,000 for lodging an appeal against the company's profits tax assessment for the year 2023/24.

3)

	$
Write-off of a staff loan (5% interest and 95% principal)	20,000
Bad debts recovered (trade debts written off in the year 2023/24)	(8,000)
Provision: 5% on the total trade debtors' balance	10,000
on specified trade debtors	53,000
Total per accounts	75,000

The loan was provided to the staff member's bank account in Hong Kong.

4) The company paid $2,500,000 to refurbish its warehouse during the year, and the relevant costs were not recorded in the income statement.

5) The company acquired the proprietary interests of two trademarks from an unrelated party. One trademark is registered in Country X with a purchase price of $5 million, and the other is unregistered, costing $2,500,000. The costs of acquiring these two trademarks were not recorded in the income statement.

You are required to:

1) Calculate the assessable profits of SL for the year of assessment 2024/25, based on the information provided. No calculation of Hong Kong Profits Tax payable is required. (12)

2) Explain how you would treat the following items for Hong Kong Profits Tax purposes:

a) Product research expenses of $1,500,000; and (4)

b) The $100,000 legal expenses. (4)

Total (20)

PART C

You are required to answer TWO questions from this Part.

5. Antonia Chan owns a residential property in Tai Po for letting purposes. She let out the property to Winnie in January 2022 for two years at a monthly rent of $16,000. Winnie moved out of the property in October 2023 with three months' rent outstanding. Antonia was unable to contact Winne via any means. The Commissioner agreed that the outstanding rent of $32,000 (after setting off the rental deposit on hand) has become irrecoverable in the year of assessment 2023/24 and has allowed the deduction under property tax.

Antonia immediately engaged a property agent to lease out the property to Apple on the following terms:

- Lease term: Two years from 1 January 2024.
- Rent: $17,000 per month payable on the first day of each month.
- Rental deposit: $34,000 payable on signing the tenancy agreement.
- Lease premium: $60,000 payable on signing the tenancy agreement.
- Rates and Government rent: $2,500 and $1,500 per quarter, respectively, payable by the owner.
- Building management fee: $1,100 per month, payable by the owner.

During the year ended 31 March 2025, Antonia paid the following expenses in relation to this property:

- Rates: $10,000
- Government rent: $6,000
- Building management fee: $13,200
- Repair to the water pipes: $5,000

In January 2025, Winnie appeared and paid Antonia $20,000 as the final settlement of the outstanding rent. She told Antonia that she had returned to Hong Kong to attend her father's funeral. She would leave Hong Kong and would not make any further payment on the outstanding rent.

Antonia received the notice of Property Tax assessment for the 2024/25 year of assessment, issued on 10 July 2025. However, she misplaced the notice and did not read the assessment until last week when she was tidying up her room. Upon reviewing the notice, she realised that she had forgotten to claim a deduction of rates in the tax return submitted in May 2025. She now wishes to lodge an objection to the tax assessment.

Assuming that today is 1 November 2025, you are required to:

1) **Compute Antonia's Property Tax liability for the year of assessment 2024/25, ignoring provisional tax. You should include all of your workings; however, explanatory notes are not required.** (7)

2) **Advise Antonia on the detailed requirements for lodging a valid objection under the Inland Revenue Ordinance, and whether or not she can object to the property tax assessment now. If not, you should advise Antonia of any alternative action she could take, including details of the action.** (8)

Total (15)

6.

1) P Co. Ltd commenced business after 1 April 1974 and prepared its accounts to 31 March each year. In September 2023, Q Co. Ltd acquired a 60% shareholding in P Co. Ltd.

In 2023, P Co. Ltd changed its accounting date to 31 December to align with that of Q Co. Ltd. The adjusted profits or (losses) of P Co. Ltd, as agreed by the Assessor of the Inland Revenue Department, are as follows:

Period	Adjusted profits/(losses) ($)
Year ended 31 March 2023	4,800,000
1 April 2023 to 31 December 2023	(1,400,000)
Year ended 31 December 2024	2,000,000

P Co. Ltd. was nominated for the two-tiered profits tax rates.

You are required to ascertain P Co. Ltd's basis period for the 2023/24 year of assessment and compute the profits tax payable by P Co. Ltd for the 2024/25 year of assessment, after any tax reduction. Your answers should be supported with reference to relevant Inland Revenue Ordinance provisions and general Inland Revenue Department practice. (7)

2) Chan & Co. carries on a manufacturing and trading business in Hong Kong. It makes up its accounts annually to 31 December.

On 1 July 2024, Chan & Co. acquired a wastewater treatment machine (which is eligible for a 30% depreciation rate if depreciation allowances apply), on hire-purchase terms, at a cash price of $400,000, for its own use. A deposit of $100,000 was paid on 1 July 2024, followed by 15 monthly instalments of $24,000 (with the first instalment due on 1 July 2024). Installation costs of $44,000 and transportation costs of $10,000 were also incurred in making the machine ready for use.

For Hong Kong Profits Tax purposes, you are required to compute the depreciation allowances and identify any other deductions to which Chan & Co may be entitled for the year of assessment 2024/25. You should show all workings, but you are not required to provide explanatory notes. (8)

Total (15)

7. Mr Lee was a Hong Kong resident before migrating to Canada in 2020 and taking up employment with a Canadian company. In January 2024, Mr Lee was asked to return to Hong Kong and serve as the chief executive officer of the Canadian company's Hong Kong subsidiary, supervising its operations in Hong Kong and mainland China. The Hong Kong subsidiary holds all directors' meetings in Hong Kong.

Mr Lee's agreement with the Hong Kong subsidiary and the Canadian holding company was made on the following terms:

a) He entered a separate employment contract with the Hong Kong subsidiary for a term of three years. The terms of the contract were negotiated via email. Mr Lee signed the contract upon his arrival in Hong Kong.

b) He was paid a monthly salary of C$10,000 by the Hong Kong subsidiary, 30% of the salary to his bank account in Canada and 70% to his bank account in Hong Kong. In addition to his monthly salary, he would be reimbursed for the actual rent paid on an apartment in Hong Kong (up to HK$20,000 per month) and for actual personal travel expenses paid (up to HK$2,000 per month). A termination lump sum payment to Mr Lee was also agreed, equal to 15% of his total salary, upon completion of the three year contract.

c) He would terminate his contract with the Canadian company upon the commencement of his contract with the Hong Kong subsidiary.

Mr Lee arrived in Hong Kong, together with his wife and two children, on 15 February 2024 and reported for duty on 1 March 2024.

Mr Lee worked in mainland China for 310 days during the 2024/25 tax year, paying Chinese income tax on income derived from his services there. He stayed and worked in Hong Kong for the remaining 55 days.

In his tax returns, Mr Lee made the following claims:

a) He was not required to pay Hong Kong salaries tax for the year of assessment 2023/24 because he did not work in Hong Kong for more than 60 days in that year.

b) For the 2024/25 year of assessment, a portion of his employment income attributable to his services rendered in mainland China should be exempt from salaries tax under s.8(1A)(c).

You are required to explain whether Mr Lee will be successful in his claims. In your answer, you should discuss the taxability of reimbursements for rental payments and personal travel expenses. You are not required to compute his taxable income. (15)

8. On 1 August 2020, Cheung Kee Ltd acquired a newly completed two-storey building from a property developer at a cost of $5 million (land value excluded). The cost of the property's construction was $4 million. The company immediately brought the property into use as a factory for its garment manufacturing operations.

With effect from 1 April 2021, Cheung Kee Ltd ceased using the building for manufacturing and leased it to its subsidiary, which used the premises as a retail shop. After one year, the lease ended and, on 1 April 2022, Cheung Kee Ltd resumed occupation of the building and once again used it for its manufacturing business.

On 1 May 2023, Cheung Kee Ltd demolished the existing two-storey building and undertook a redevelopment of the site into a ten-storey factory building at a construction cost of $20 million, intending to hold the new building for resale to the public.

Subsequently, on 1 September 2024, Cheung Kee Ltd sold the entire ten-storey building (excluding the land value) to Keen Tai Ltd for $30 million. Keen Tai Ltd immediately put the building into use for manufacturing purposes.

All companies prepare their accounts to 31 March each year.

You are required to compute the industrial and commercial building depreciation allowances available to Cheung Kee Ltd and Keen Tai Ltd, for all relevant years of assessment. (15)

Tax Rates and Allowances

	2024/25
Tax Rates	
Property tax and salaries tax:	
Two-tiered standard rates	
First $5,000,000	15%
Remainder	16%
Salaries tax:	
Progressive rates	
First $50,000	2%
Next $50,000	6%
Next $50,000	10%
Next $50,000	14%
Remainder	17%
Profits Tax:	
Non-corporate profits tax rates	
First $2,000,000 (if two-tiered tax rates apply)	7.5%
Remainder	15%
Corporate profits tax rates	
First $2,000,000 (if two-tiered tax rates apply)	8.25%
Remainder	16.5%
Tax Reduction (where applicable)	
Percentage of reduction	100%
Maximum per case	$1,500
Personal Allowances	$
Basic	132,000
Married person's	264,000
Child – 1st to 9th (each)	130,000
Additional (for year of birth, each)	130,000
Dependent parent / grandparent (each)	
Basic (aged 55 or above but below 60: $25,000)	50,000
Additional (aged 55 or above but below 60: $25,000)	50,000
Dependent brother / sister (each)	37,500
Single parent	132,000
Personal disability	75,000
Disabled dependant (each)	75,000
Deductions (maximum)	
Self-education expenses	100,000
Home loan interest – basic	100,000
– additional	20,000
Elderly residential care expenses	100,000
Contributions to recognised retirement schemes	18,000
VHIS policy premiums (for each insured person)	8,000
Annuity premiums and tax deductible MPF voluntary contributions	60,000
Domestic rents – basic	100,000
– additional	20,000
Assisted reproductive service expenses	100,000

Depreciation Allowance

Plant and machinery

Initial – 60%

Annual – Air-conditioning plant: 10%

Furniture and fixtures, office equipment, room air-conditioning units, domestic appliances: 20%

Motor vehicles, electronic data processing equipment (computer), electric cookers, production machine: 30%

Industrial building

Initial – 20%

Annual – 4% or formula

Commercial building

Annual – 4% or formula

Stamp Duty

Conveyance on sale of immovable property (from 26 February 2025 onwards)

Consideration	**Scale 1** Part 1	**Scale 2**
Not exceeding $4,000,000	$100	$100
$4,000,001 – $4,500,000	1.5%	1.5%
$4,500,001 – $6,000,000	2.25%	2.25%
$6,000,001 – $9,000,000	3%	3%
$9,000,001 – $20,000,000	3.75%	3.75%
Over $20,000,000	4.25%	4.25%

Lease of immovable property

Term of lease	**Rate**
Not defined or uncertain	0.25% of yearly or average yearly rent
Not exceeding 1 year	0.25% on total rent payable over lease term
> 1 year but not exceeding 3 years	0.5% on yearly or average yearly rent
> 3 years	1% on yearly or average yearly rent

Transfer of Hong Kong stock (from 17 November 2023 onwards)

Contract note: 0.1%

Instrument of transfer: $5

Arrangement between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation (Extracts)

ARTICLE 5
PERMANENT ESTABLISHMENT

1. In this Arrangement, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term "permanent establishment" includes especially:

    (1) a place of management;
    (2) a branch;
    (3) an office;
    (4) a factory;
    (5) a workshop;
    (6) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

3. The term "permanent establishment" also encompasses:

    (1) a building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than 6 months;

    (2) the furnishing of services, including consultancy services, by an enterprise of One Side in the Other Side, directly or through employees or other personnel engaged by the enterprise, but only if such activities continue (for the same or a connected project) for a period or periods aggregating more than 183 days within any 12-month period.

4. Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:

    (1) facilities used solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;

    (2) a stock of goods or merchandise belonging to the enterprise kept solely for the purpose of storage, display or delivery;

    (3) a stock of goods or merchandise belonging to the enterprise kept solely for the purpose of processing by another enterprise;

    (4) a fixed place of business established solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise;

    (5) a fixed place of business established solely for the purpose of carrying on any other activity of a preparatory or auxiliary character for the enterprise;

    (6) a fixed place of business established solely for any combination of the activities mentioned in subparagraphs (1) to (5) of this paragraph, provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

5. Notwithstanding the provisions of paragraphs 1 and 2 but subject to the provisions of paragraph 6, where a person is acting in One Side on behalf of an enterprise and, in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are:

    (1) in the name of the enterprise; or
    (2) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use; or
    (3) for the provision of services by that enterprise,

    that enterprise shall be deemed to have a permanent establishment in that One Side in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make the fixed place of business a permanent establishment under the provisions of that paragraph.

6. Paragraph 5 shall not apply where the person carries on business in One Side as an independent agent and acts in that One Side on behalf of an enterprise of the Other Side in the ordinary course of that business. Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which that person is closely related, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise."

7. The fact that a company which is a resident of One Side controls or is controlled by a company which is a resident of the Other Side, or which carries on business in that Other Side (whether through a permanent establishment or otherwise), shall not of itself constitute any company of any One Side a permanent establishment of a company of the Other Side.

8. For the purposes of this Article, a person is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50% of the beneficial interest in the other (or, in the case of a company, more than 50% of the voting rights and value of the company's shares or of the beneficial equity interest in the company) or if another person possesses directly or indirectly more than 50% of the beneficial interest (or, in the case of a company, more than 50% of the voting rights and value of the company's shares or of the beneficial equity interest in the company) in the person and the enterprise."

ARTICLE 7
TAXATION OF BUSINESS PROFITS

1. The profits of an enterprise of One Side shall be taxable only in that Side unless the enterprise carries on business in the Other Side through a permanent establishment situated therein. If the enterprise carries on business in the Other Side through a permanent establishment situated therein, its profits may be taxed in the Other Side, but only so much of them as is attributable to that permanent establishment.

2. Subject to the provisions of paragraph 3 of this Article, where an enterprise of One Side carries on business in the Other Side through a permanent establishment situated therein, there shall in each Side be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

3. In determining the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the business of the permanent establishment including executive and general administrative expenses so incurred, whether in the Side in which the permanent establishment is situated or elsewhere. However, no such deduction shall be allowed in respect of amounts (other than reimbursement of actual expenses) paid by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, remuneration, fees or any other similar payments in return for the use of patents or other rights, or by way of commission for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the permanent establishment. Likewise, no account shall be taken, in determining the profits of a permanent establishment, for amounts (other than reimbursement of actual expenses) charged by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, remuneration, fees or any other similar payments in return for the use of patents or other rights, or by way of commission for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the head office of the enterprise or any of its other offices.

4. Insofar as it has been customary in One Side to determine the profits to be attributed to a permanent establishment by apportioning the total profits of the enterprise to its various units or by any other methods provided for in the laws, nothing in paragraph 2 shall preclude that Side from determining the profits to be taxed by such method. However, the result of adopting such method shall be in accordance with the principles contained in this Article.

5. No profits shall be attributed to a permanent establishment by reason only of the purchase by that permanent establishment of goods or merchandise for the enterprise.

6. For the purposes of the preceding paragraphs, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason for a deviation.

7. Where profits include items of income which are dealt with separately in other Articles of this Arrangement, then the provisions of those Articles shall not be affected by the provisions of this Article.

ARTICLE 8
SHIPPING, AIR AND LAND TRANSPORT

1. Income and profits derived by an enterprise of One Side from the operation of ships, aircraft or land transport vehicles in shipping, air and land transport shall be exempt from tax (including value added tax in the Mainland of China) in the Other Side (except where the ships, aircrafts or land transport vehicles are solely operated between places of the Other Side).
2. The provisions of paragraph 1 of this Article shall also apply to income and profits derived from participation in partnership business, joint venture business or international business agency, to the extent of the income and profits that is proportional to the shareholding of such business.

ARTICLE 10
DIVIDENDS

1. Dividends paid by a company which is a resident of One Side to a resident of the Other Side, may be taxed in that Other Side.

2. However, such dividends may also be taxed in the Side of which the company paying the dividends is a resident, and according to the laws of that Side, but if the beneficial owner of the dividends is a resident of the Other Side, the tax so charged shall not exceed:

   (1) where the beneficial owner is a company directly owning at least 25% of the capital of the company which pays the dividends, 5% of the gross amount of the dividends;

   (2) in any other case, 10% of the gross amount of the dividends.

   The competent authorities of both Sides shall by mutual agreement settle the mode of application of these limitations.

   This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

Article 11
INTEREST

1. Interest arising in One Side and paid to a resident of the Other Side may be taxed in that Other Side.

2. However, such interest may also be taxed in the Side in which it arises and according to the laws of that Side, but if the beneficial owner of the interest is a resident of the Other Side the tax so charged shall not exceed 7% of the gross amount of the interest.

   The competent authorities of both Sides shall by mutual agreement settle the mode of application of this limitation.

ARTICLE 12
ROYALTIES

1. Royalties arising in One Side and paid to a resident of the Other Side may be taxed in that Other Side.

2. However, such royalties may also be taxed in the Side in which they arise and according to the laws of that Side, but if the beneficial owner of the royalties is a resident of the Other Side the tax so charged shall not exceed 7% of the gross amount of the royalties. The competent authorities of both Sides shall by mutual agreement settle the mode of application of this limitation.

3. The term “royalties” as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific works including cinematograph films, or films or tapes used for radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial, or scientific equipment or for information concerning industrial, commercial or scientific experience.

ARTICLE 13
CAPITAL GAINS

1. Gains derived by a resident of One Side from the alienation of immovable property referred to in Article 6 and situated in the Other Side may be taxed in that Other Side.

2. Gains derived from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of One Side has in the Other Side, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise), may be taxed in that Other Side.

3. Gains derived by an enterprise of One Side from the alienation of ships or aircraft or land transport vehicles operated in shipping, air and land transport or movable property pertaining to the operation of such ships, aircraft or land transport vehicles, shall be taxable only in that Side.

4. Gains derived by a resident of One Side from the alienation of shares or comparable interests, such as interests in a partnership or trust, may be taxed in the Other Side if, at any time during the three years preceding the alienation, these shares or comparable interests derived more than 50% of their value directly or indirectly from immovable property, as defined in Article 6, situated in that Other Side.

5. Gains derived by a resident of One Side from the alienation of shares, other than the shares referred to in paragraph 4, or other rights in the capital of a company which is a resident of the Other Side may be taxed in that Other Side if, at any time within the 12 months before the alienation, the recipient of the gains had a participation, directly or indirectly, of not less than 25% of the capital of the company.".

6. Gains derived from the alienation of any property, other than that referred to in paragraphs 1 to 5, shall be taxable only in the Side of which the alienator is a resident.

ARTICLE 14
INCOME FROM EMPLOYMENT

1. Subject to the provisions of Articles 15, 17, 18, 18A, 19 and 20, salaries, wages and other similar remuneration derived by a resident of One Side in respect of an employment shall be taxable only in that One Side unless the employment is exercised in the Other Side. If the employment is exercised in the Other Side, such remuneration as is derived therefrom may be taxed in that Other Side.

2. Notwithstanding the provisions of paragraph 1 of this Article, remuneration derived by a resident of One Side in respect of an employment exercised in the Other Side shall be taxable only in that One Side if all the following 3 conditions are satisfied:

   (1) the recipient is present in the Other Side for a period or periods not exceeding in the aggregate 183 days in any 12-month period commencing or ending in the taxable period concerned;

   (2) the remuneration is paid by, or on behalf of, an employer who is not a resident of the Other Side;

   (3) the remuneration is not borne by a permanent establishment which the employer has in the Other Side.

ARTICLE 18A
TEACHERS AND RESEARCHERS

1. Where an individual is employed by a university, college, school in One Side or by an educational institution or scientific research institution recognized by the Government of One Side and is, or was immediately before visiting the Other Side, a resident of that One Side and is present in that Other Side for the primary purpose of teaching or research at a university, college, school in that Other Side or at an educational institution or scientific research institution recognized by the Government of that Other Side, the remuneration derived by the individual in respect of such teaching or research, to the extent it is paid by, or on behalf of, the employer of that One Side, shall not be taxed in that Other Side for a period of three years, provided that such remuneration is subject to tax in that One Side.

2. The period of "three years" provided in paragraph 1 of this Article shall begin on the date of the individual's first arrival in the Other Side for the above purpose or the date from which the provisions begin to apply under paragraph 2 of Article 7 of this Protocol, whichever is the later.

3. Paragraph 1 of this Article shall not apply to income derived from research if such research is undertaken not in the public interest but primarily for the private benefit of a specific person or persons."

ARTICLE 24A
ENTITLEMENT TO BENEFITS UNDER THE ARRANGEMENT

Notwithstanding the other provisions of this Arrangement, a benefit under this Arrangement shall not be granted in respect of an item of income if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Arran