

# THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2024

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## MODULE 2.04 – HONG KONG OPTION

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### ADVANCED INTERNATIONAL TAXATION (JURISDICTION)

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TIME ALLOWED – 3¼ HOURS

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

**PART A**

**You are required to answer BOTH questions from this Part.**

1. Cat HK Ltd (CHKL) was incorporated in Hong Kong and provides consultancy services to clients in Hong Kong and mainland China. CHKL closes its accounts on 31 December every year.

CHKL had provided IT consultancy services to a client in mainland China for the period from 1 July 2022 to 31 December 2023. CHKL's Hong Kong office received the service order via emails from the client. The order was processed by CHKL's IT consultancy division and accepted by CHKL's directors in Hong Kong. In this regard, CHKL's three IT managers visited the client's office in mainland China, where they provided consultancy services.

The managers' travel and accommodation were arranged by CHKL's Hong Kong office. CHKL did not maintain any office in mainland China, and the services fee was paid to CHKL's bank account in Hong Kong. The servicing periods of the three IT managers in mainland China were as follows:

- Manager A: 1 July – 30 September 2022
- Manager B: 1 December 2022 – 28 February 2023
- Manager C: 15 August – 31 December 2023

For the years ending 31 December 2022 and 31 December 2023, CHKL received dividend income of \$1 million and \$500,000 respectively from Samson Ltd (SL), which is incorporated and based in mainland China. CHKL had held 30% of shares in SL since 1 January 2021, and sold a third of its shareholding (i.e. 10% of the total shares in SL) on 1 January 2023.

**You are required to:**

- 1) **Comment on the Hong Kong Profits Tax position of CHKL, in relation to the consultancy fee income received from the client in mainland China.** (12)
- 2) **Comment on the China Enterprise Income Tax position of CHKL, in relation to the consultancy fee income received from the client in mainland China, in the context of the double tax agreement (DTA) between mainland China and Hong Kong.** (8)
- 3) **Comment on the China Enterprise Income Tax position and Hong Kong Profits Tax position of CHKL in relation to the dividend income received from SL for 2022 and 2023, in the context of the DTA between mainland China and Hong Kong and with reference to the relevant rules in Hong Kong.** (5)

Total (25)

2. Blueberry Ltd (BL) conducts business in the technology sector in Hong Kong.

BL licensed the right to use two types of production know-how to a company, Strawberry China Ltd (SCL), which is tax resident in mainland China. During the year ending 31 March 2023, BL derived two types of royalty income from SCL:

- Type A (\$10 million)  
BL carried out technology research and development work in Hong Kong, and Type A know-how was utilised in mainland China by SCL.
- Type B (\$15 million)  
BL sourced the right (including a sub-licensing right) to use Type B know-how from a Country B company, Hugo Ltd (HL), with the license agreement negotiated and concluded in Hong Kong. Type B know-how was also used in mainland China by SCL. Type B know-how was developed by HL in Country B.

The license agreement for Type A know-how was negotiated and concluded with SCL in mainland China, while the license agreement for Type B know-how was negotiated and concluded with SCL in Hong Kong. BL paid a royalty of \$5 million to HL for the right (including a sub-licensing right) to use Type B know-how for the year ending 31 March 2023. BL also paid \$500,000 in Value Added Tax (VAT), which was charged on the gross royalty amount in Country B for the year ending 31 March 2023

HL held 100% of shares in BL throughout the year ending 31 March 2023. Before setting up BL in Hong Kong, HL had maintained a branch in Hong Kong to handle its business there. Upon the establishment of BL, HL transferred all business of the Hong Kong branch to BL and ceased all branch business. HL will not elect for the two-tiered tax rate in Hong Kong if it is subject to Hong Kong Profits Tax. There is no double tax agreement (DTA) between Hong Kong and Country B.

For the year ending 31 March 2023, BL paid interest expenses of \$900,000 in relation to a \$20 million loan borrowed from a bank in Country B. The loan was taken out on 1 April 2022 in order to purchase scientific equipment for use in BL’s business. HL provided all securities for the loan, including a bank deposit with a Singaporean bank of \$20 million and shares in a Singaporean listed company valued at \$10 million, throughout all relevant times. HL received interest income of \$600,000 from the deposit and dividend income of \$400,000 from the shares in the year ending 31 March 2023.

**You are required to.**

- 1) **Explain the Hong Kong Profits Tax treatment, as well as the Chinese income tax treatment, of BL’s royalty incomes, in the context of the DTA between mainland China and Hong Kong.** (9)
  - 2) **Explain the Hong Kong Profits Tax implications of:**
    - a) **the \$5 million royalty fee to HL and \$500,000 VAT paid in Country B; and** (11)
    - b) **the \$900,000 interest expenses on the bank loan.** (5)
- Total (25)

**PART B**

**You are required to answer ONE question from this Part.**

3. Smart Ltd (SL) carries on a business developing and producing integrated circuits in Hong Kong, for which all sale profits are subject to Hong Kong Profits Tax. Its provisional income statement for the year ending 31 December 2022 shows a net pre-tax profit of \$17 million, after crediting income and expenditure as follows:

<u>Income</u>	<u>Note</u>	<u>\$</u>
Interest income from RMB deposit	(1)	75,000
Exchange Gain from RMB deposit	(1)	230,000
<u>Expenditure</u>		
Interest expenses – Loan 1	(1)	37,000
Interest expenses – Loan 2	(2)	400,000
Forfeited deposit	(3)	100,000

Explanatory Notes

- 1) In January 2022 SL’s finance director, Dennis, anticipated that the Chinese renminbi would appreciate in value against the Hong Kong dollar. He therefore arranged for SL to borrow \$4 million from Hang Seng Bank (Loan 1) and used the funds to purchase renminbi, which were placed on a one-month fixed deposit with the same bank. The deposit was used as security for Loan 1. SL rolled over the deposit for four consecutive months, earning interest income of \$75,000. In May 2022, SL reconverted the principal sum to Hong Kong dollar and made a gain of \$230,000. During the period, interest expenses of \$37,000 were paid on Loan 1.
- 2) The interest expenses of \$400,000 were incurred in relation to a bank loan (Loan 2), secured by an equivalent amount overseas bank deposit of SL’s overseas holding company, Ultimate Ltd (UL). Loan 2 was used to finance the construction costs of a research laboratory for the development of new production know-how, to be applied by SL. The construction of the research laboratory started on 1 January 2022 and was completed on 30 November 2022. SL incurred construction costs of \$4.6 million, excluding the interest expense, and these construction costs were not charged to the income statements. The laboratory was put into use in January 2023. UL derive interest income of \$300,000 from the overseas deposit.
- 3) SL succeeded in bidding for a five-year lease of a piece of vacant land in Hong Kong. The company’s intention was to use the land as a parking area for delivery trucks. However, the company later abandoned its plan and the deposit of \$100,000 paid to the landowner was forfeited.

**You are required to:**

- 1) **Calculate the Profits Tax payable by SL for the 2022/23 year of assessment, ignoring provisional tax.** (6)
- 2) **Explain the Profits Tax treatments of the following items:**
  - a) **The exchange gain of \$230,000 from the renminbi deposit;** (4)
  - b) **The interest expenses of \$37,000 on Loan 1;** (2)
  - c) **The interest income of \$75,000 from the renminbi deposit; and** (4)
  - d) **The interest expenses on Loan 2 of \$400,000 and construction costs of the research laboratory of \$4.6 million.** (4)

Total (20)

4. Modest Printing Ltd (MPL) is principally engaged in the printing business in Hong Kong, including the printing of newspapers, magazines and books.

In order to expand its business, MPL intends to acquire ten printing machines at a cost of \$2 million each. MPL's management are contemplating ways of financing this acquisition, and have approached a subsidiary company, Wonderful Ltd (WL), about the possibility of a sale and lease back arrangement. WL is incorporated and based in Country A, where it has carried on a leasing business.

MPL's management have sought your advice on whether the proposed lease payment from MPL to WL would be tax-deductible. In addition, the management of MPL and WL are curious as to whether, from the perspective of the applicable tax anti-avoidance rules, the machines could be sold on to WL at a 10% mark-up on the planned acquisition price paid by MPL and a rental payment from MPL to WL then set, based on this selling price (i.e. the discounted present value of all future rental payments would be equal to the selling price).

**You are required to outline the tax implications of the proposed sale and lease back arrangement, in the context of:**

- 1) **anti-avoidance rules specifically relating to sale and lease back transactions; and** (7)
- 2) **the general anti-avoidance and general deduction provisions.** (13)

Total (20)

**PART C**

**You are required to answer TWO questions from this Part.**

5. Richard Lam is a resident of Country X. He started to invest in Hong Kong real estate property in the year 2022. He bought a residential property in Hong Kong, which was let to Helen at a monthly rent of \$15,000 in March 2022. Richard obtained a rental deposit of \$30,000 from Helen; however, Helen has not paid any rent since March 2022.

On 30 June 2022, Helen informed Richard that she would move out from the property immediately but that she was unable to pay the outstanding rent. Richard has been unable to contact Helen since then. The Inland Revenue Department agreed during that year that the rent had become irrecoverable. Richard also found out that Helen had not paid the management fee, which she should have paid directly to the management office according to the terms of the tenancy agreement.

Richard immediately engaged a property agent to lease out the property and incurred costs of \$35,000 in renovating the property. Richard entered into a lease with Justin on 20 July 2022 on the following terms:

- Lease term: Two years from 1 August 2022.
- Monthly rent: \$16,000, payable on the first day of each month.
- Lease premium: \$60,000, payable at the commencement of the lease.
- Rental deposit: \$32,000, payable upon the signing of the lease agreement.
- Rates and government rent: \$2,600 and \$1,560 respectively per quarter, payable by the owner.
- Management fee: \$1,200 per month, payable by the tenant to the owner as collection agent of the property management office.
- The owner was to be responsible for any repair expenses relating to the property, unless the damage was caused by the tenant.

In March 2023, Justin spent \$800 replacing a leaking water tap which had become defective due to normal wear and tear. He did not claim reimbursement from Richard, as the amount was small and he wished to maintain a good relationship with his landlord.

During the year ending 31 March 2023, Richard paid the following expenses:

- Rates and government rent for the whole year;
- Commission of \$16,000 to the property agent for introducing the tenant;
- Bank interest of \$93,500 for a loan borrowed to finance the acquisition of the property; and
- A management fee of \$6,000 for the period from March to July 2022.

**You are required to:**

- 1) **Calculate the Property Tax payable by Richard for the 2022/23 year of assessment. You may ignore provisional tax, and explanatory text is not required.** (10)
- 2) **Explain the circumstances under which a repayment of tax may occur, and the time limit for seeking a refund.** (5)

Total (15)

6. Reading Ltd (RL), a company resident in Country R, manufactures and sells domestic appliances. Seeing Ltd (SL), a resident of Hong Kong that is a wholly owned subsidiary of RL, owns a store where it sells appliances that it acquires from RL. RL also owns a small warehouse in Hong Kong, in which it stores a few large items that are identical to some of those displayed in SL's store. When a customer buys such a large item from SL, SL employees visit the warehouse and take possession of the item before delivering it to the customer. Ownership of the item is only transferred from RL to SL when the item leaves the warehouse.

SL plans to use its own internal funds to provide an interest-free loan to RL, which will finance its operating expenses relating to the warehouse in Hong Kong. SL has not provided any loans to other related parties.

There is no double tax agreement between Hong Kong and Country R.

**You are required to discuss the Hong Kong Profits Tax implications for RL and SL of the activities described.** (15)

7. Ms Fung was a resident of Country Y and was employed by Rogan Ltd (RL), a Hong Kong-based company, as a sales manager in the year 2023. RL's office is situated in Lantau Island, Hong Kong. Ms Fung has provided you with the following information for the year ending 31 March 2023:

- Ms Fung received an annual salary of \$600,000.
- To facilitate her work, RL provided Ms Fung with a flat in Hong Kong and deducted a sum of \$1,200 every month from her salary for payment of the building management fee. Ms Fung lived in the flat from Monday to Thursday each week, and lived in her own flat in Tseung Kwan O, Hong Kong, from Friday to Sunday. Her family remained in the Tseung Kwan O flat throughout the year.
- RL paid \$6,000 per month for Ms Fung's medical insurance policy. According to the contract signed between RL and the insurance company, Ms Fung's husband would guarantee the payment of the premium in case it was defaulted by RL. Ms Fung received \$5,000 from the insurance company as a partial reimbursement of her medical expenses, which totalled \$8,000 during the course of the year.
- Ms Fung purchased a car at a cost of \$200,000 for the purpose of meeting clients. She paid running expenses for the car of \$50,000 over the course of the year. It was agreed with the Assessor that the business use portion of the car's use amounted to 50%. These expenses were not refunded by RL. Full depreciation allowance on the car was \$144,000, before taking into account the 50% business use.
- RL paid \$25,000 to buy a package tour to Japan for Ms Fung. Ms Fung redeemed the package and obtained a sum of \$20,000 in December 2022.
- On 10 May 2022, Ms Fung was granted a share option to subscribe for 30,000 shares in the company at \$5 each. She paid \$10,000 for the option and, on 3 August 2022, fully exercised the option to buy the shares.
- On 2 January 2023, Ms Fung was unconditionally awarded 10,000 shares in recognition of her outstanding performance in sales negotiations. However, she was not permitted to sell the shares for one year from the date of the award.
- The shares were quoted in the stock market at the following prices:
 

- 10 May 2022	\$9
- 3 August 2022	\$10
- 2 January 2023	\$12
- Ms Fung has contributed \$28,000 to the Mandatory Provident Fund (MPF) scheme during the course of the year.
- Ms Fung enrolled and attended a masters programme in marketing offered by a Hong Kong university and paid tuition fees of \$60,000. She obtained a refund of \$10,000 from the Continuing Education Fund.
- Ms Fung's husband was not employed by any company but ran a retail shop, and sustained an allowable tax loss of \$100,000 during the year ending 31 March 2022 from the shop. Mr and Ms Fung have a son, aged 18 during the year, who was studying at a boarding school in the United Kingdom.
- Ms Fung's father, aged 63 during the year, was living in a registered elderly care home in Hong Kong. Ms Fung paid residential care expenses of \$70,000 for him. Mr Fung's parents, aged 54 and 56, were resident in Hong Kong. Mr Fung paid his parents \$8,000 per month to support their living expenses.

**You are required to calculate the net chargeable income for Ms Fung for the 2022/23 year of assessment. You must include all steps in your computation, but no explanatory text is required. (15)**

8. Berry Investment Ltd (BIL) is incorporated and based in Country Z. In the year 2023, it started to invest in Hong Kong property and acquired a three-storey building (which was not a mill, factory or other similar premises), which it let to three different tenants.

The ground floor tenant carries on a second-hand car trading business. Half of the floor is used as a showroom, while the remaining half is used as a workshop where motor cars are polished and tuned before being placed in the showroom.

The first floor tenant manufactures and sells appliances. It uses the floor for the production of appliances.

The second floor tenant is a fashion trading company, which uses this floor as a warehouse. The goods purchased from overseas suppliers are sorted, repackaged and repaired if necessary, and stored in this warehouse, before distributing to the local retailers.

**You are required to determine whether BIL is entitled to industrial building allowance in respect of each of the three floors, and provide the basis on which each determination is made.** (15)



2022/23Tax Rates

Standard rate	15%
Corporate profits tax rate	
First \$2,000,000 (if two-tiered tax rates apply)	8.25%
Remainder	16.5%
Progressive rates	
First \$50,000	2%
Next \$50,000	6%
Next \$50,000	10%
Next \$50,000	14%
Remainder	17%

Tax Reduction (where applicable)

Percentage of reduction	100%
Maximum per case	\$6,000

Personal Allowances

	\$
Basic	132,000
Married person's	264,000
Child – 1 <sup>st</sup> to 9 <sup>th</sup> (each)	120,000
Additional (for year of birth, each)	120,000
Dependent parent / grandparent (each)	
Basic	50,000
(aged 55 or above but below 60: \$25,000)	
Additional	50,000
(aged 55 or above but below 60: \$25,000)	
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	100,000
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	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 November 2020 to 10:59am 22 February 2023)

Consideration	Scale 1	Scale 2
Not exceeding \$2,000,000	15%	\$100
\$2,000,001 – \$3,000,000		1.5%
\$3,000,001 – \$4,000,000		2.25%
\$4,000,001 – \$6,000,000		3%
\$6,000,001 – \$20,000,000		3.75%
Over \$20,000,000		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

Buyer's stamp duty: 15%

Special stamp duty (for immovable property acquired on or after 27 October 2012)

Held for 6 months or less	20%
Held for > 6 months but 12 months or less	15%
Held for > 12 months but 36 months or less	10%

Transfer of Hong Kong stock

Contract note: 0.13%  
Instrument of transfer: \$5

**Agreement between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation (Extracts) [for the years of assessment up to and including 2022/23]**

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 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 Arrangement.