HONG KONG TAX ALERT

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Shenzhen-Hong Kong Stock Connect – A New Chapter In Connecting the Capital Markets in Mainland China and Hong Kong

Summary

- The Shenzhen-Hong Kong Stock Connect, which commenced on 5 December 2016, allows Mainland Chinese and Hong Kong investors to trade stocks on each other's market.
- Hong Kong investors will be temporarily exempt from tax on capital gains derived from the trading of PRC shares.
- Capital gains derived from the trading of Hong Kong shares by Mainland Chinese individual investors will be exempt from Individual Income Tax for three years.

Following the China Securities Regulatory Commission's (CSRC) and the Hong Kong Securities and Futures Commission's (SFC) announcement on 25 November 2016, the trading of stocks under the new Shenzhen-Hong Kong Stock Connect programme started on 5 December 2016. At the same time, the Ministry of Finance (MOF), the State Administration of Tax (SAT) and CSRC issued a notice explaining the tax treatment of stocks traded under the Shenzhen programme *[Note 1]*.

Background

The Shanghai-Hong Kong Stock Connect has operated smoothly since its formal launch on 17 November 2014. This has paved the way for the launch of the Shenzhen-Hong Kong Stock Connect. The new programme means that the capital markets in Mainland China and Hong Kong will be connected more comprehensively.

The two mechanisms connecting the stock markets in Mainland China and Hong Kong are as follows:-

	Shenzhen-Hong Kong Stock Connect		Shanghai-Hong Kong Stock Connect	
	Northbound	Southbound	Northbound	Southbound
Number of eligible stocks (as of 25 November 2016)	**881** (Main Board: 267 GEM Board: 411 ChiNext Board: 203)	**417**	**569**	**315**
Daily quota	RMB 13 billion	RMB 10.5 billion	RMB 13 billion	RMB 10.5 billion
Aggregate quota	Abolished			

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Eligible investors	Hong Kong and overseas investors **(ChiNext stocks** are only eligible **for institutional professional investors)**	Mainland China institutional investors and individuals with >RMB 500,000 cash and securities on account	Hong Kong and overseas investors	Mainland China institutional investors and individuals with >RMB 500,000 cash and securities on account

What distinguishes the Shenzhen programme from the Shanghai programme is that investors can trade shares listed on the GEM of the Shenzhen Stock Exchange. However, during the initial phase of the Shenzhen programme, only institutional investors, as defined under Hong Kong laws, qualify for such trades. Other investors will have to wait until relevant regulatory matters are resolved.

The CSRC and the SFC have also agreed to work together to introduce other financial products and to include exchange-traded funds within the scope of the investments which may be traded, when conditions are suitable.

Tax effects

The PRC tax treatment of stocks traded under the Shenzhen programme, including PRC Corporate Income Tax (CIT) / Individual Income Tax (IIT), Value Added Tax (VAT) and Stamp Duty, is summarized below:-

Investors		**PRC CIT / IIT**		**PRC VAT**	**Stamp Duty**
		Capital Gains	**Dividends**		
Hong Kong and foreign investors investing in PRC shares via Shenzhen-Hong Kong Stock Connect or QFII / RQFII	Individuals / Corporations	Temporarily exempt	Withholding tax rate of 10% generally (subject to potential tax treaty relief)	Exempt	Seller subject to Hong Kong Stamp Duty of 0.1% on the sale of A-shares
	QFII / RQFII	Temporarily exempt from CIT on gains derived from 17 November 2014 onwards; pre-17 November 2014 gains are taxable			
PRC investors investing in Hong Kong shares via Shenzhen-Hong Kong Stock Connect	Individuals	Temporarily exempt from IIT for three years (from 5 December 2016 to 4 December 2019)	IIT at 20%	Exempt	Both seller and purchaser of Hong Kong listed shares are subject to Hong Kong Stamp Duty of 0.1%
	Corporations	CIT at 25%	CIT at 25% (other than interest in qualifying H-shares)		

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Summary

Like the Shanghai programme, the Shenzhen-Hong Kong Stock Connect is a landmark in integrating and internationalizing the capital markets in Mainland China and Hong Kong. The IIT exemption granted to Mainland investors under the Shenzhen programme will expire shortly before the end of 2019, while the IIT exemption under the Shanghai programme will expire by the end of 2017. We expect that the Mainland China authorities will introduce tax rules before those dates to further clarify the tax issues arising under both Stock Connect programmes.

KPMG China will closely follow the development of tax procedures, including any administrative guidance which may be issued by the Mainland China tax authorities after launching the Shenzhen programme. Investors in the capital markets in Mainland China and Hong Kong who have any questions about tax compliance and planning are welcome to contact KPMG professionals for more advice.

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[1] *Tax Treatment For the Pilot Programme of Shenzhen-Hong Kong Stock Connect*, Caishui [2016] No 127, issued on 1 December 2016.

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Contact us:

Khoon Ming Ho
Regional Leader Tax, Asia Pacific
Head of Tax, KPMG China
Tel: +86 10 8508 7082
khoonming.ho@kpmg.com

Ayesha M. Lau
Head of Local Market
Head of Tax, Hong Kong
Tel: +852 2826 7165
ayesha.lau@kpmg.com

Corporate Tax

Chris Abbiss
Head of Real Estate Tax, KPMG China
Tel: +852 2826 7226
chris.abbiss@kpmg.com

Stanley Ho
Partner
Tel: +852 2826 7296
stanley.ho@kpmg.com

Charles Kinsley
Partner
Tel: +852 2826 8070
charles.kinsley@kpmg.com

Jocelyn Lam
Partner
Tel: +852 2685 7605
jocelyn.lam@kpmg.com

Alice Leung
Partner
Tel: +852 2143 8711
alice.leung@kpmg.com

Curtis Ng
Partner
Tel: +852 2143 8709
curtis.ng@kpmg.com

John Timpany
Partner
Tel: +852 2143 8790
john.timpany@kpmg.com

Matthew Fenwick
Director
Tel: +852 2143 8761
matthew.fenwick@kpmg.com

Sandy Fung
Director
Tel: +852 2143 8821
sandy.fung@kpmg.com

Ivor Morris
Director
Tel: +852 2847 5092
ivor.morris@kpmg.com

Natalie To
Director
Tel: +852 2143 8509
natalie.to@kpmg.com

Michael Olesnicky
Special Advisor
Tel: +852 2913 2980
michael.olesnicky@kpmg.com

M & A Tax

Darren Bowdern
Head of Financial Services Tax, KPMG China
Tel: +852 2826 7166
darren.bowdern@kpmg.com

Yvette Chan
Partner
Tel: +852 2847 5108
yvette.chan@kpmg.com

Benjamin Pong
Partner
Tel: +852 2143 8525
benjamin.pong@kpmg.com

Malcolm Prebble
Principal
Tel: +852 2685 7472
malcolm.j.prebble@kpmg.com

China Tax

Karmen Yeung
Partner
Tel: +852 2143 8753
karmen.yeung@kpmg.com

Daniel Hui
Principal
Tel: +852 2685 7815
daniel.hui@kpmg.com

Adam Zhong
Principal
Tel: +852 2685 7559
adam.zhong@kpmg.com

Travis Lee
Director
Tel: +852 2143 8524
travis.lee@kpmg.com

Steve Man
Director
Tel: +852 2978 8976
steve.man@kpmg.com

Transfer Pricing

John Kondos
Partner
Tel: +852 2685 7457
john.kondos@kpmg.com

Lu Chen
Principal
Tel: +852 2143 8777
lu.l.chen@kpmg.com

Irene Lee
Director
Tel: +852 2685 7372
irene.lee@kpmg.com

Global Mobility Services

Barbara Forrest
Principal
Tel: +852 2978 8941
barbara.forrest@kpmg.com

Murray Sarelius
Principal
Tel: +852 3927 5671
murray.sarelius@kpmg.com

David Siew
Principal
Tel: +852 2143 8785
david.siew@kpmg.com

Erica Chan
Director
Tel: +852 3927 5572
erica.chan@kpmg.com

Kate Lai
Director
Tel: +852 2978 8942
kate.lai@kpmg.com

US Tax

Wade Wagatsuma
Head of US Corporate Tax, KPMG China
Tel: +852 2685 7806
wade.wagatsuma@kpmg.com

Becky Wong
Director
Tel: +852 2978 8271
becky.wong@kpmg.com

Indirect Tax

Lachlan Wolfers
Head of Indirect Tax, KPMG China Regional Leader, Asia Pacific Indirect Tax
Tel: +852 2685 7791
lachlan.wolfers@kpmg.com

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