Hong Kong (SAR) Tax Alert

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The Hong Kong SAR and Mauritius entered into a double tax agreement

Summary

The Hong Kong SAR (Hong Kong) recently signed a comprehensive double taxation agreement (CDTA) with Mauritius. Benefits under the CDTA include: reduced withholding tax (WHT) rates for interest and royalties, elimination of WHT on service/consultancy fees and tax exemption for business profits in the absence of a permanent establishment.

Hong Kong signed a CDTA[1] with Mauritius on 7 November 2022. It represents the 46th CDTA signed by Hong Kong and 56th CDTA signed by Mauritius. The CDTA will enter into force after completion of the ratification procedures in both Hong Kong and Mauritius. The earliest possible effective dates of the CDTA will be from 1 July 2023 in Mauritius and from year of assessment 2023/24 (which begins on 1 April 2023) in Hong Kong.

Key features of the CDTA

Tax residency (Article 4)

- An entity meeting the tax residency rules in both Mauritius and Hong Kong[2] shall be tax resident only in the Contracting State where its place of effective management is situated.

Permanent establishment (Article 5)

The definition of PE largely follows that in the United Nations Model Double Taxation Convention 2021 and include:

- Fixed place PE – includes a branch, an office, a factory, **a warehouse (for providing storage facilities for others)** and a mine, an oil or gas well;
- Construction site PE – for building site, construction/installation project or activities that last more than six months;
- Service PE - for provision of services (for the same or a connected project) for a period or periods aggregating more than 183 days in any 12-month period; and
- Agency PE - the following person (other than an independent agent) will constitute an agency PE of e.g. a Hong Kong resident in Mauritius:
  - ➢ A person who has, and habitually exercises, an authority to conclude contracts in Mauritius in the name of the Hong Kong resident; or
  - ➢ A person who habitually maintains a stock of goods or merchandise in Mauritius from which he regularly delivers goods or merchandise on behalf of the Hong Kong resident.

1 The CDTA can be accessed via this link: https://www.ird.gov.hk/eng/pdf/Agreement_Mauritius_HongKong.pdf
2 A company incorporated in Hong Kong or a company incorporated outside Hong Kong but being normally managed or controlled in Hong Kong is a Hong Kong resident.

The CDTA has not incorporated the various measures recommended by the OECD under Action 7 of the BESP 1.0 Action Plan[3] to tackle artificial avoidance of PE such as measures to deal with specific activity exemptions and fragmentation of activities between closely related parties.

Profits from international shipping and air transport (Article 8)

Profits from international shipping and air transport derived by a Hong Kong resident from Mauritius will be tax-exempt in Mauritius. Such profits not only include profits from the operation of ships or aircraft for the transport of persons and goods, etc. in international traffic but also encompass:

- (1) income from leasing of ships or aircraft on a bareboat charter basis, (2) income from sale of tickets and provision of services connected with such transport and (3) profits from leasing of containers, provided that such income/profits are incidental to the operation of ships or aircraft in international traffic; and
- interest on funds directly connected with the operation of ships or aircraft in international traffic.

Dividends, interest, royalties and technical service fees (Article 10, 11 and 12)

The WHT rates under the domestic laws of Hong Kong and Mauritius as well as the CDTA on dividends, interest, royalties and technical service fees are as follows:

	Dividends	Interest	Royalties	Consultancy fees
Mauritius non-CDTA rate	0%	0%/15%	0%/15%	5%
HK non-CDTA rate	0%	0%	2.475% to 4.95%	0%
HK/Mauritius CDTA rate[4]	0%/5%[5]	0%/5%[6]	5%[7]	0%

Capital gains (Article 13)

Mauritius and Hong Kong currently do not impose any taxes on capital gains from sale of shares derived by non-residents not conducting a business in the jurisdiction. Should Hong Kong or Mauritius introduce capital gains tax or a WHT on such gains in the future, the CDTA provides a tax exemption from disposal of shares:

- gains derived from alienation of shares of a non-property rich company (i.e. a company with 50% or less of its asset value derived from immovable property situated in Mauritius or Hong Kong); and
- gains derived from alienation of shares of a property rich company (i.e. a company with more than 50% of its asset value derived from immovable property situated in Mauritius or Hong Kong) under the following circumstances:
    - alienation of shares listed on recognised stock exchanges;
    - alienation of shares under a reorganisation of company, a merger, a scission or any similar arrangements; or
    - alienation of shares in a company deriving more than 50% of its asset value from immovable property in which it carries on its business.

Elimination of double taxation (Article 22)

Under the CDTA, double taxation in Hong Kong will be eliminated by way of tax credit – i.e. any Mauritius taxes paid under the laws of Mauritius and in accordance with the CDTA in respect of income derived by a Hong Kong resident from Mauritius will be allowed as a credit against the tax payable in Hong Kong in respect of that income, subject to a cap of the Hong Kong tax payable on that income.

On the other hand, the domestic law of Mauritius already allows for taxes suffered overseas to be used as credit in Mauritius, subject to a cap of the Mauritius tax payable on that income.

3 The OECD's final report on BEPS Action 7 can be accessed via this link:9789264241220-en.pdf (oecd-ilibrary.org)
4 There is a beneficial ownership requirement in the Dividends, Interest and Royalties articles.
5 Since Hong Kong and Mauritius currently do not impose any WHT on dividends, the conditions for applying the 0% rate / the 5% rate under the CDTA would only become relevant should Hong Kong or Mauritius impose a WHT on dividends in the future.
6 The 0% rate applies to interest paid to the Hong Kong and Mauritius government and other specified government bodies. The 5% rate applies to all other cases.
7 The definition of "royalties" in the CDTA does not include rentals from use of industrial, commercial or scientific equipment.

Entitlement to benefits (Article 27)

The CDTA has incorporated the “principal purposes test” for preventing treaty shopping which applies to all articles in the CDTA including the Dividends, Interest, Royalties and Capital gains articles.

KPMG observations

We welcome the signing of the CDTA between Hong Kong and Mauritius. It signifies the efforts of both the Hong Kong and Mauritius governments to promote economic and trade connections between the two places. The CDTA is compliant with most of the latest international tax principles and is likely to boost investments between the two jurisdictions.

Under the CDTA, Hong Kong resident companies may benefit from (1) the reduced WHT rates on interest or royalties derived from Mauritius and (2) a tax exemption for business profits (including service fee income) in Mauritius in the absence of a PE in Mauritius. On the other hand, Mauritius resident companies may enjoy a number of tax exemptions on income from Hong Kong including tax exemption on their business profits in Hong Kong in the absence of a PE in Hong Kong.

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