
# Hong Kong Signs Double Tax Agreement with Korea

*A Double Taxation Agreement between Hong Kong and the Republic of Korea was signed on 8 July 2014 and will enter into force when ratification procedures are completed*

Hong Kong concluded a Double Tax Agreement (DTA) with the Republic of Korea last week which will enter into force after the completion of ratification procedures on both sides. If the ratification process can be concluded in 2014, the DTA will be effective on 1 April 2015 in Hong Kong and 1 January 2015 in Korea (in respect of Korean withholding taxes at source, this will become effective on 1 April 2015).

The DTA allocates taxing rights between Hong Kong and Korea and provides for reduced withholding tax rates and gives investors clarity on their potential tax liabilities arising from cross-border activities.

## Active Income

In the absence of the DTA, income earned by Korean residents in Hong Kong is subject to both Hong Kong and Korean income tax. Under the DTA, however, tax paid in Hong Kong will be allowed as a credit against the Korean tax payable by a Korean resident.

The DTA also provides for a credit against Hong Kong tax payable in respect of any Korean tax paid. This situation may occur in the rare circumstances where Hong Kong companies with profits attributable to a permanent establishment in Korea are also liable for tax in Hong Kong where such profits are considered to be sourced in Hong Kong.

## Passive Income

The Korean dividend withholding tax on Hong Kong residents will be reduced from 20% to either 15% or 10%. The reduced rate of 10% applies to shareholdings of 25% and above.

The DTA provides for interest withholding tax to be reduced from 20% (14% in the case of government and domestic corporation bonds) to 10% while Korean withholding tax on royalties, currently at 20%, will be limited to 10%.

The DTA includes an exchange of information article based on the current OECD model treaty standard and also contains a limitation on benefits article that is similar to the "main purpose test" proposed by the OECD in its discussion draft regarding BEPS Action 6. Under the limitation on benefits article, treaty benefits may be denied when one of the main purposes of arrangements or transactions is to secure a benefit under the DTA which would be contrary to the object and purpose of the relevant provisions of the DTA.

In order for the DTA to be ratified by Hong Kong, an order is required by the Chief Executive in Council under the Inland Revenue Ordinance, which is subject to negative vetting by the Legislative Council.

| | Korea Non-treaty Withholding Rate | Treaty Withholding Rate |
|---|---|---|
| **Dividends** | 20% | 10%[1]/15% |
| **Interest** | 14%[2]/20% | 10% |
| **Royalties** | 20% | 10% |

[1] Withholding tax on dividends is reduced to 10% if the beneficial owner is a company (other than a partnership) that controls directly at least 25% of the capital of the company paying the dividends.

[2] Domestic withholding tax of 14% applies to interest on bonds issued by the central government, local government or domestic corporation.

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