

HONG KONG TAX ALERT

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Hong Kong and South Africa conclude Double Tax Agreement

A Double Tax Agreement (DTA) between Hong Kong and South Africa is expected to take effect in 2016.

Summary

- Hong Kong concluded a Double Tax Agreement (DTA) with South Africa, its first with an African jurisdiction.
- The DTA will enter into force after the completion of ratification procedures on both sides. It is expected to take effect on 1 April 2016 in Hong Kong and 1 January 2016 in South Africa.
- The DTA allocates taxing rights between the two jurisdictions, provides for reduced withholding tax rates and gives investors greater certainty on their potential tax liabilities arising from cross-border activities.
- The DTA also contains a number of favourable provisions that should encourage closer cooperation between Hong Kong and South Africa.

In October 2014 Hong Kong concluded a Double Tax Agreement (DTA) with South Africa, its first with an African jurisdiction and its 31st overall. The DTA allocates taxing rights between the two jurisdictions, provides for reduced withholding tax rates and gives investors greater certainty on their potential tax liabilities arising from cross-border activities. In addition, the DTA contains a number of favourable provisions that should encourage closer cooperation between Hong Kong and South Africa.

The DTA will enter into force after the completion of ratification procedures on both sides. If the ratification process can be concluded in 2015, the DTA will be effective on 1 April 2016 in Hong Kong and 1 January 2016 in South Africa.

Active Income

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

The DTA also provides for a credit against Hong Kong tax payable in respect of any South African tax paid. This situation may occur in rare situations where Hong Kong companies with profits attributable to a permanent establishment in South Africa are also liable for tax in Hong Kong when such profits are regarded as sourced in Hong Kong.

Passive Income

The South African dividend withholding tax on Hong Kong residents will be reduced from 15% to either 5% or 10%, the lower rate being applicable where the beneficial owner of the dividends is a company which has a direct holding of at least 10% of the capital of the payer.

The DTA provides for South African withholding tax on interest to be capped at 10%. This is particularly relevant as the previous blanket exemption for interest paid to non-residents who did not have a permanent establishment in South Africa was replaced on 1 January 2015 with a final withholding tax based on 15% on the gross amount of interest from a South African source.

This rate may be reduced to 0% if the beneficial owner of the interest is the Hong Kong Government, Monetary Authority or any institution that is wholly or mainly owned by Hong Kong Government as is approved by both jurisdictions' revenue authorities.

The South African withholding tax on royalties is, under the DTA, reduced from 15% to 5% (the South African withholding rate on royalties having been increased from 12% from 2015 onwards).

Other Notable Provisions

The DTA contains a number of provisions that are worthy of mention:

- The definition of Permanent Establishment is similar to that contained in United Nations Model Convention, particularly insofar as a construction permanent establishment has a 6 month threshold, provision is made for service permanent establishments and the list of permanent establishment exclusions (usually referred to as *preparatory and auxiliary activities*) does not contain *delivery* (with the consequence that a delivery activity may constitute a permanent establishment).
- It is provided that where a Hong Kong enterprise or individual is entitled to fees for technical, management or consultancy services from a South African source and they are not attributable to a permanent establishment, such fees will not be subject to any South African withholding tax. Similar to interest, this is relevant as South Africa will introduce a withholding tax on service fees (in respect of any amount received or accrued for technical, managerial services and consultancy services but will not include services incidental to imparting scientific, technical, industrial or commercial knowledge) effective from 1 January 2016.
- The DTA includes an exchange of information article based on the current OECD model treaty standard and a domestic anti-abuse measure.

South Africa's withholding tax on Hong Kong residents:

	South African Non-treaty Withholding Rate	Treaty Withholding Rate
Dividends	15%	5%/10%
Interest	15%	0%/10%
Royalties	15%	5%

Through its holding company regime and network of tax treaties, South Africa has established itself as an important location for a holding company for investment within in Africa. This treaty, when effective, will offer an attractive route into Africa and warrants consideration by those considering investments into Africa.

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Transfer Pricing

US Tax

Indirect Tax

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