Tax & Legal

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LT in focus

Draft double tax treaty between Russia and Hong Kong

On 7 December 2015, the Russian Government approved a draft double tax treaty between the Russian government and the government of the Hong Kong Special Administrative Region of the People Republic of China (hereinafter referred to as the DTT, Draft DTT). This DTT is the latest in a series of draft DTTs have been developed and signed recently between Russia and Asian countries that may directly affect the investment strategies of Russian individuals and businesses. In November 2015 Russia and the Re-public of Singapore signed a Protocol on amending the DTT between the countries, and in October 2014, Russia signed a new DTA with China

This DTT specifies the criteria for recognition of individuals and legal entities as tax residents of the contracting states; introduces tie breaker for resolving residency conflicts; criteria as to what constitutes a permanent establishment and taxation procedures for different types of income.

The DTT will apply to Hong Kong in terms of income tax, salary income tax and property income tax, and to Russia in terms of Profits tax and Personal Income Tax

The DTT will only come into force after it is signed and ratified by both parties, and the parties circulate diplomatic notes.

The draft DTT introduces a number of significant amendments, including the following:

- Residency of individuals and businesses
- Permanent establishment criteria
- Taxation of dividends, interests and royalties
- Taxation of income derived from the sale of shares
- Methods to avoid double taxation
- Information exchange
- Validation procedure for tax residency certificates
- Additional measures to prevent abusive practices

Residency of individuals and businesses

The DTT defines criteria for recognition of tax residents separately for Russia and Hong Kong.

Hong Kong	• Individuals who reside or remain in Hong Kong more than 180 days during a tax year or over 300 days during two tax periods; • Legal entities registered in Hong Kong • Foreign legal entities that are typically managed or controlled from Hong Kong • Other entities registered or managed / controlled from Hong Kong (including trusts and partnerships)	Residence conflict: Individuals: place of habitual real estate, place of vital interests or place of living take priority Businesses: place of effective management takes priority
Russia	Any entity subject to taxation in Russia due to the following criteria: • Place of residence / permanent residence / registration • Place of effective management • Any other similar criteria	

Permanent establishment criteria

The DTT defines criteria for what constitutes a permanent establishment for taxation purposes. A perma-nent establishment emerges in the following cases:

- Place of management / branch office / office
- Workshop / factory
- Natural resources extraction site
- Rendering services that require relocating employees for 183+ days
- A construction site in place 12+ months

Taxation of dividends, interests and royalties

Dividends	• 5%, in case the recipient is regarded as beneficial owner of the income and his ownership share exceeds 15% • 10% in all other cases	Limitation of benefits: Benefits are not applied if the sole purpose or one of the purposes of the person participating in the establishment of the structure was to benefit from the DTT.
Interest	0% (despite formal absence of beneficial ownership requirements, this criterion could in practice be applied by tax authorities)	
Royalty	Not exceeding 3%, in case the recipient is regarded as beneficial owner of the income	

Taxation of income derived from the sale of shares

Draft Agreement establishes that the income derived from the sale of shares, if over 50% of its value directly or indirectly comes from real estate located in the contractual states, is subject to taxation in such a state, unless the real estate is located in a state, in which such a company conducts its business.

Methods to avoid double taxation

Double taxation is avoided through tax credit in both contracting states. The amount of the tax credit shall not exceed the amount of the tax applied to relevant income calculated according to the national legislation of the contracting state.

Exchange of information between state authorities

The DTT stipulates that information that may be deemed relevant to the implementation of the provisions of the DTT may be exchanged between the responsible authorities of the contracting states, or provided to the administration or law enforcement bodies of the contracting states.

It should be noted that Hong Kong could be included into the List of States and Territories Not Exchanging Tax Information with Russia (see draft decree "On approving the List of States and Territories Not Exchanging Tax Information with Russia"). However, the process for exchanging tax information between Russian and Hong Kong may be put in place after the Agreement comes into effect.

Validation procedure for tax residency certificates

The Protocol to the DTT stipulates that a tax residency certificate (or any other document) issued by the relevant authorities of Hong Kong does not need to be validated or affixed with an apostille in order to be recognized in Russia.

Additional measures to prevent abusive practices

Nothing in the DTT limits the right of the contracting states to apply their national laws and measures aimed at preventing tax avoidance, regardless of what they are called.

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The intent of Russia and Hong Kong opens up new possibilities for both Russian and Asian businesses. Moreover, such an agreement along with the territorial taxation system, coupled with a well-developed infrastructure and banking system will allow Hong Kong to compete with the Asian financial centers such as Singapore, on the one hand, and popular European jurisdictions that have imposed sanctions against Russia, on the other hand.

We hope that you will find the information presented in this issue useful. Our specialists are ready to answer any questions you may have regarding the topic presented.

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