



LT In Focus

Overview of Russia's double tax treaties with China and Hong Kong

Recently, a number of double tax treaties (DTTs) have been signed with Asian governments that could benefit the investment strategies of Russian/Asian entities and individuals. In November 2015, Russia and Singapore signed a protocol to amend the DTT between them (for more details, see LT in Focus of 28 August 2015). In December 2015, the Russian government approved a draft DTT between Russia and Hong Kong, which was signed on 18 January 2016. On 27 January 2016, the law on ratification of the new DTT between Russia and China (which was signed in October 2014 and amended by Protocol on 8 May 2015) passed through the Russian Federal Council.

The DTTs will enter into force after they are signed by the parties, ratified, and diplomatic notes are exchanged.

In this edition, we compare the provisions of the DTTs with China and Hong Kong.

Both DTTs are based on the OECD Model Tax Convention and contain tax residency criteria for individuals and legal entities, tiebreaker rules, permanent establishment criteria and withholding tax rates for different types of income.

The DTTs introduce the following rules with regard to:

- Residency of individuals and legal entities;
- Permanent establishment;
- Taxation of dividends, interests and royalty;
- Taxation of income derived from the disposal of immovable property;
- Methods for elimination of double taxation
- Exchange of information;
- Validation procedures for tax residency certificates;
- Additional measures to prevent abusive practices.

Residency of individuals and legal entities

The DTTs provides for tiebreaker rules for resolution of residence conflicts for both individuals and legal entities.

For individuals, residence conflicts should be resolved based on the following:

- permanent home;
- center of vital interests;
- habitual abode;
- nationality;
- by mutual resolution of competent local authorities of the parties to the DTT.

In cases of residence conflicts for legal entities, the place of effective management will take the priority.

Permanent establishment (PE)

Both DTTs envision similar criteria for what constitutes a PE for taxation purposes, which include:

- the place of management;
- the existence of a branch, office, factory, workshop;
- a natural resources extraction site;
- the furnishing of services, including consultancy services (for the same or a connected project) through employees or other personnel engaged for such purpose for a period or periods aggregating 183 days in any twelve month period;
- a construction site.

Activities of a taxpayer at a construction site will be deemed as carried out through a PE in 12 months in Hong Kong and in 18 months in China.

Neither DTT considers that a PE is established though preparatory and auxiliary activities, including collection of information or purchase of goods. Additionally, the DTT with China stipulates that maintaining a warehouse to supply goods belonging to the resident of another contracting state should be regarded as preparatory / auxiliary activity that does not lead to PE recognition.

Taxation of dividends, interests and royalty

The effective DTT with China provides for at least 10% withholding tax rate on passive Russian-sourced income (dividends, interests and royalty). Since no DTT is currently in effect with Hong Kong, at the moment, the standard withholding tax rates (15% for dividends and 20% for interests and royalty) are applied to passive Russian-sourced income. After the newly concluded DTTs come into effect, the withholding tax rates for dividends, interests and royalty will be set as the following:

	Dividends			Interest	Royalty
	Major shareholding	Minor shareholding	"Major shareholding" criteria		
China	5%	10%	25% + at least EUR 80,000 investment	0%	6%
Hong Kong	5%	10%	15%	0%	3%

Both DTTs envision tax exemption or reduced withholding tax rates for beneficial owners only.

Both DTTs also provide for additional limitations of benefits in cases where a special relationship between the borrower and the beneficial owner leads to the establishment of an interest rate and royalty different from those that would have been established under similar conditions by independent parties.

Taxation of income derived from the disposal of immovable property

Both DTTs establish that income derived from the sale of immovable property may be taxed in the state where the immovable property is located.

Similar rules apply to the disposal of shares deriving more than 50% of their value directly or indirectly from immovable property. However, the DTT with Hong Kong provides for a number of exceptions applicable to shares that:

- are traded on stock exchanges;
- have been alienated or exchanged during a reorganization, merger, split or similar transaction;
- that derive more than 50% of the value from immovable property in which the taxpayer carries out its business activity.

The DTT with Hong Kong notes that treaty benefits should not be applicable in cases where one or more of the primary objectives of disposing of the property was to derive benefits under the DTT.

Methods for elimination of double taxation

Both DTTs provide for tax credit method for elimination of double taxation. The amount of tax credit is limited to the amount of tax payable on the income under the national legislation of the taxpayer's state of residence.

Exchange of information between competent authorities

Under the DTTs, the relevant authorities of the contracting states can exchange information related to the application of the DTTs or the administration or enforcement of the domestic laws concerning taxes of every kind and description insofar as the taxation thereunder is not contrary to the DTTs.

Notably, the Protocol to the DTT with Hong Kong specifies the possibility of exchanging information to control the calculation and payment of VAT.

Importantly, Hong Kong appears on the list of states and territories that do not exchange information for taxation purposes with Russia (see [draft Decree "On approving the list of states and territories not exchanging information for taxation purposes with Russia"](#)). However, Hong Kong may be removed from the list after the DTT enters into force and the information begins to be exchanged between the states.

Validation procedure for tax residency certificates

Protocols to the DTTs provide that any document or certificate of residence issued by the competent authorities of Russia, China and Hong Kong shall not require legalization for the purposes of application, including their use in the courts and administrative bodies.

Additional measures to prevent abusive practices

Nothing in the DTTs limits the right of the contracting states to apply its national legislation or measures concerning tax avoidance.

The DTT with China details criteria that need to be met in order to apply the DTT. For instance, the concept of "qualified" resident is introduced, which encompasses all individuals, state and charity organizations as well as organizations whose shares are traded on stock exchanges and their subsidiaries. Apart from "qualified" residents, the right to tax benefits is extended to residents that carry out active entrepreneurial activities. In this case, an entrepreneurial activity does not include holding or investment activities except for those carried out by banks, insurance companies and security traders).

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After the respective DTTs enter into force, new opportunities will be opened up for both Russian companies and Asian investors. As an example, the withholding tax exemption on interest income together with the well-developed infrastructure and banking system in Asia are likely to enable Asian countries to compete with popular western jurisdictions in terms of debt-financing Russian businesses in the time of sanctions against Russia.

Additionally, after enactment of the DTT with Hong Kong it may become an attractive holding jurisdiction for Russian assets, since in addition to considerably low withholding tax rates its internal legislation provides for territorial taxation system (stipulating that income gained outside Hong Kong could be exempt from taxation) and the absence of withholding tax on outbound dividends.

We hope that you will find the information in this edition interesting and useful. Please feel free to contact our experts on any topics related to this subject.

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