



GES NewsFlash

Hong Kong – Update: Japan-Hong Kong Tax Agreement Now Signed

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Summary

In a previous GES NewsFlash, we announced that consensus had been reached between Japan's Ministry of Finance and the Hong Kong Inland Revenue Department for a new double tax agreement. On November 9, 2010, Japan and Hong Kong signed the agreement on the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income (DTA).

Background

Prior to implementation of the DTA, the taxation of employment income for business travelers between Japan and Hong Kong is governed by domestic tax laws only.

As Japan has no domestic exemption from tax for short-term business visitors, a business traveler from Hong Kong is technically subject to Japan individual income tax on employment income whenever working in Japan. This could also trigger a withholding requirement for a branch of the payer in Japan.

Hong Kong's domestic regulations allow non-residents to spend up to 60 days per tax year visiting in Hong Kong before triggering a Hong Kong tax exposure. In general, the Hong Kong Inland Revenue Department will regard a taxpayer's occasional trips to Hong Kong as visits if he/she is based outside of Hong Kong and is required to render services overseas as a permanent employee. This 60 day exemption rule does not apply to income from directorship.

New treaty

The Japan/Hong Kong DTA will come into force after the completion of ratification procedures in both jurisdictions. It is currently expected that the DTA will become effective from January 1, 2012 for Japan, and April 1, 2012 for Hong Kong.

Taxation of employment income (Article 14)

The new DTA largely follows the OECD model tax convention. Under the

Japan/Hong Kong DTA, a resident of one jurisdiction will not be taxed on employment income derived in respect of an employment exercised in the other jurisdiction, provided:

- the individual is present in the other jurisdiction for a period or periods not exceeding in aggregate 183 days in any 12 months commencing or ending in the tax year;
- the remuneration is paid by, or on behalf of, an employer who is not a resident of the other jurisdiction; and
- the remuneration is not borne by a permanent establishment which the employer has in the other jurisdiction.

Taxation of directors' fees (Article 15)

Regardless of the number of days spent in the jurisdiction, director's fees for carrying out duties in the capacity of a member of the board of director of a company may be taxed in the jurisdiction in which that company is located. Fees paid from Japanese corporations to director are regarded a Japan-source income under domestic law and so Japan will retain the right to tax this income even after the treaty is in effect.

Exchange of information (Article 25)

Under the new DTA, the competent authorities of both countries will be able to exchange information concerning taxes, which they believe to be relevant for carrying out their duties in their respective jurisdictions.

Impact upon business travelers to Hong Kong

As noted above, under the Hong Kong domestic legislation, business travelers, who do not spend more than 60 days in a tax year are exempt from Hong Kong Salaries Tax. Under the new DTA, it is now possible for these assignees to be exempt from Salaries Tax in Hong Kong for up to 183 days, provided they satisfy all the conditions set in Article 14 (2) and are regarded as resident of Japan under the treaty.

Deloitte's View

It is worth noting that 183 days is counted in any consecutive 12 month period in the case of the Japan/Hong Kong DTA, unlike in a calendar year which applies in some treaties, such as in the case of the Japan/China DTA. Special care is therefore required to track short-term assignees from Japan to Hong Kong, Japan to China, Hong Kong to China, and vice versa.

Impact upon business travelers to Japan

Business travelers from Hong Kong to Japan may now be able to exempt employment income from Japan taxable income as long as they remain non-

resident in Japan for treaty purposes, the employment income is not paid in Japan or borne by a Permanent Establishment (PE) of the employer in Japan and their presence in Japan does not exceed a total of 183 days in a 12 month period ending in the tax year concerned. If a business traveler qualifies for treaty relief, he/she cannot claim the unilateral tax relief under Hong Kong tax legislation as the employment income has not been subject to Japan income tax.

Deloitte's View

The current situation whereby business travelers from Hong Kong are subject to Japan income tax under domestic law, creates a greater tax compliance burden upon business travelers from Hong Kong who are subject to Japan tax, compared to those visiting Japan from countries whose tax treaty with Japan allows employment income to be exempt from Japan taxable income.

Therefore, this new DTA should be welcomed by employees and employers alike who, if qualifying for treaty relief, should find their tax affairs simplified by remaining only subject to tax in the home jurisdiction. This is especially welcome given that the Salaries Tax rate in Hong Kong (15%) is lower than the non-resident national tax rate on employment income in Japan (20%). (The Japan resident tax rate is up to 50%).

Claiming the treaty exemption for employment income

In Hong Kong, it is still not clear whether business travelers will be required to file a tax return to claim treaty exemption under Article 14 (2) of the DTA if he/she spends more than 60 days but less than 184 days in Hong Kong during a tax year, and we are currently awaiting confirmation from the Hong Kong Inland Revenue Department in this regard. We, however, believe an individual needs to submit a tax resident certificate of Japan to substantiate his/her claim. For Japan, where treaty relief is available, it will not be necessary to file an individual income tax return to claim the relief unless an exemption from withholding is required.

Deloitte's View

A perception exists outside of Hong Kong that Hong Kong income tax rules are simple. With the increased number of cross-border assignees we have seen recently, however, income tax compliance of these business travelers is becoming more complex. In addition, attention should be drawn with respect to the potential corporate tax exposures in the host jurisdiction. We have seen a growing number of enquiries from the Hong Kong Inland Revenue Department in this area.

For Japan, the new treaty should reduce the number of individuals who become subject to Japan tax for even short visits to Japan which would benefit those travelers by reducing tax compliance relating to their business trips to Japan and having to claim foreign tax credits in the home jurisdiction.

However, whilst the DTA may indeed benefit many employers and employees in the region by reducing the instances when business travelers between Hong Kong and Japan incur tax liabilities outside their home jurisdiction, it does still require careful monitoring of those travelers to ensure that treaty relief is applicable and if so, that the appropriate returns are filed to claim the benefit.

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