Entry into force of the Tax Treaty between South Africa and Hong Kong

10 December 2015

In brief

The Tax Treaty (and Protocol) between Hong Kong and South Africa has been ratified by both countries with the date of entry into force from 20 October 2015. In South Africa, it was published in the Government Gazette on 24 November 2015.

The provisions of the treaty will apply in Hong Kong for years of assessment beginning on or after 1 April 2016. In South Africa, it will apply from 1 January 2016 for amounts held at source, and for years of assessment beginning on or after 1 April 2016 in respect of other taxes.

In detail

In general, the treaty follows the OECD Model Tax Convention. We highlight below some of the departures from the Model and other notable clauses.

Taxes covered

This treaty does not cover any penalties or interest imposed under domestic law. Presumably, this means that penalties and interest arising from non-or-late-compliance might still be chargeable notwithstanding that the actual tax amount might be Nil.

Residency

Hong Kong

Given that Hong Kong is not a sovereign state, the term "national" is different from the traditional OECD Model definition.

An individual will be a resident in Hong Kong if he or she:

- ordinarily resides there; or
- stays there for more than 180 days during a year of assessment; or
- stays there for more than 300 days over two consecutive years of assessment.

Companies and other persons will be resident in Hong Kong if they are either incorporated or constituted in Hong Kong, or if they are normally managed or controlled in Hong Kong.

South Africa

The treaty uses the traditional OECD Model concept for the term "resident" of South Africa.

Tie-breaker

In case of individuals, the tie-breaker clause follows the traditional OECD Model, with the exception that Hong Kong instead refers to the individual's "national" status as 'the right of abode'.

In case of any other person, the primary tie-breaker is the place of effective management. The secondary test, i.e. in case of doubt about where the place of effective management is exercised, is the mutual agreement determination between the competent authorities. If agreement is not reached, most of the treaty benefits will not apply.

Permanent Establishment

Service PE

The permanent establishment ('PE') definition is extended beyond the traditional OECD definition to include a services

PE. Such a PE would arise if an enterprise furnishes services through its employees of an enterprise (or other personnel) within the source state in relation to a project exceeding in aggregate 183 days in any twelve month period.

Construction PE

Building sites or construction, assembly or installation projects (etc.) will be deemed to be a PE if the project or activity lasts for more than six months.

Attribution rules

In line with the OECD Model, the business profits article (Art 7(1)) only allows the source state to tax profits attributable to the local PE.

The attribution rules to calculate the business profits only go so far as to specify that expenses can be deducted if it were incurred for the purpose of the PE, which includes executive and general administrative expenses, irrespective of where it was incurred. The treaty is silent as regard to how to deal with notional income and expenses.

It is settled in the treaty that profits will not be attributed to a PE merely because it bought goods or merchandise for the enterprise.

Capital Gains on property investments

The treaty includes the property-rich-company clause in Article 13. The source country will have taxing rights on capital gains on the sale of shares in companies that derive more than 50% of their value from immovable property situated in the source state.

There are however exceptions to this rule, in which case the resident state will have sole taxing rights. These exceptions are shares:

- listed on the Johannesburg Stock Exchange or Stock Exchange of Hong Kong Ltd (or any other agreed-upon stock exchange); or
- in a company deriving more than 50% of its value from immovable property in which it carries on its business.

Tax rate reduction

The treaty will offer a number of tax rate reductions which are considered to be favourable compared to the treaties that South Africa has with other countries.

Dividends

A maximum tax rate of 5% applies if the beneficial owner is a company and holds directly at least 10% of the capital of the payer company - otherwise a maximum of 10% applies.

Interest

Interest is exempt if it is paid to the following persons:

In the case of Hong Kong

- Government of the Hong Kong Special Administrative Region;
- Hong Kong Monetary Authority;
- Any institution owned by the Government of the Hong Kong Special Administrative Region (as agreed between the competent authorities).

In the case of South Africa

- Government of SA (and any political subdivision / local authority)
- SA Reserve Bank
- Any institution owned by the Government of South Africa (as agreed between the competent authorities).

In any other case, where the beneficial owner of the interest is a resident of the resident state, the maximum tax rate is 10%.

Royalties

The treaty applies a maximum tax rate of 5% on royalties where the beneficial owner of the income stream is a resident of the other state.

Below is a summary of the domestic withholding tax rates and the reduced rates under the treaty:

	Hong-Kong %	SA %	Treaty Rates for SA %
Royalties	5	15	5
Interest	0	15	10
Dividends	0	15	5/10

Main purpose test

Critically, however, the dividends, interest and royalties clauses include a main purpose test as a specific anti-treaty-abuse mechanism. Treaty relief will not be available if the main purpose (or one of the main purposes) of the arrangement - i.e. equity holding, financing, or intellectual property rights - was to take advantage of these articles.

The takeaway

The treaty applies from 2016 and generally follows the OECD Model. It offers several beneficial reliefs, but also has a clear anti-abuse inclination —noted in the tie-break for corporate residence, the taxation of indirect interests in immovable property, and the main purpose test for passive income flows.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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