

LEGAL ALERT

**DOUBLE TAXATION RELIEF AGREEMENT BETWEEN MACAU &
HONG KONG**

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Introduction

It is generally accepted in the international community that double taxation is unjust and hinders the exchange of goods and services as well as movements of capital, technology and human resources, undermining the development of economic relations between economies.

Although many jurisdictions may provide unilateral tax relief to their residents, an agreement to set taxation rights between two jurisdictions and the relief on tax rates on different types of income certainly helps investors better assess their potential tax liabilities from cross-border economic activities, foster economic and trade links and provide incentives to conduct business or investment.

In line with those objectives, Macau and Hong Kong have signed a Double Taxation Relief Agreement on November 2019 (the “**Hong Kong-Macau DTRA**” or “the **DTRA**”). On 16 of September 2020, the Macau Chief Executive has gazetted an official notice confirming that the procedures for implementing the **Hong Kong-Macau DTRA** have (finally) been completed and that it became effective in both Special Administrative Regions since 18 August 2020. As result it will be applicable in relation to income attributable to the fiscal year of 2021.

The **Hong Kong-Macau DTRA** is based on OECD’s model tax convention on income and capital¹ and is aimed at further developing the already closely intertwined economic relations between the two Special Administrative Regions.

¹ The latest version of which is dated 2017. The latest model convention has been updated in accordance with the final reports produced by the OECD/G20 Base Erosion and Profit Shifting Project (BEPS).

Scope of the Hong Kong-Macau DTRA and general territorial taxation principles in Macau and Hong Kong

Personal scope

The **Hong Kong-Macau DTRA** applies to residents of one or both parties. Article 4 provides a definition of Hong Kong residents for the purposes of the **DTRA**, while the definition of Macau resident is referred to its internal law by reason of domicile, residence, place of incorporation, place of management or other criterion of a similar nature.

An individual is considered a Hong Kong resident if his/her habitual residence is in Hong Kong or, irrespectively, of his habitual residence, he/she spends over 180 days in a fiscal year or 300 days in two consecutive fiscal years in Hong Kong. Corporations are considered Hong Kong residents according to the place of management criterion.

Rules to determine the prevailing residency in case a person is found to be a resident in both jurisdictions are also provided in article 4.

The concept of residency serves several purposes under the **DTRA**: (i) it determines the agreement's personal scope of application; (ii) to solve situations where double taxation could arise as result of double residency and (iii) to solve situations where double taxation could arise as result of taxation under the residency and source of income principle.

Objective scope

The **Hong Kong-Macau DTRA** applies to the following taxes in Macau:

- Complementary Tax (corresponding to the Profits Tax in Hong Kong), which concerns to income deriving from commercial and industrial business.
- Professional Tax (corresponding to the Salaries Tax in Hong Kong), which taxes income arising from employment work and from (certain) independent professions; and
- Urban Property Tax (corresponding to the Property Tax in Hong Kong), which taxes (actual or potential) income resulting from immovable urban property.

International or inter-territorial double (legal) taxation means the imposition of comparable taxes by more than one tax jurisdiction to one person in respect of the same source of income. It arises from the use of different taxation criteria in different jurisdictions.

Generally, income tax is applied in different jurisdictions according to two criteria: the tax residency principle and the source of income principle. Hong Kong generally adopts the source of income principle, according to which only income sourced from Hong Kong is subject to taxation in Hong Kong, whereas Macau combines several criteria according to the type of income:

- a) Macau Complementary Tax is applicable in accordance with the two criteria referred above. As such, it applies to the worldwide income received by Macau domiciled taxpayers and to any income obtained in Macau by non-residents resulting from industrial and commercial activities.
- b) Professional tax applies in accordance with the source principle, i.e. to salaries and other remuneration received by employees and certain professionals sourced in Macau or received for services provided or sourced in Macau, irrespectively of their tax residency.
- c) Urban Property Tax is applicable in accordance with the source (location) principle, i.e. to the income resulting from urban property located in Macau.

Both as result of the different taxation principles referred above as well as due to concurrent territorial connecting factors, several situations of double taxation may verify. For example, the income deriving from employment sourced in Hong Kong may be taxed both in Hong Kong and in Macau if the employee is assigned to temporarily work in Macau. Similarly, the income obtained by a Macau based company sourced in Hong Kong may be concurrently subject to Profits Tax in Hong Kong and to Complementary Tax in Macau.

The purpose of the **Hong Kong-Macau DTRA** is to eliminate (or, at least, alleviate) double taxation on income through the allocation of taxing rights between the two SARS without creating opportunities for tax evasion or reduced taxation (“tax shopping”). For this reason, the **DTRA** may not apply to residents of any of the parties in circumstances of tax shopping or when the benefits are found attributable to a resident of a third jurisdiction, pursuant to the provisions of article 27.

Allocation of taxation rights under the Hong Kong-Macau DTRA

The general taxation principle established under the Hong Kong-Macau **DTRA** is the residency principle, according to which taxation will be restricted to the jurisdiction of residency of the individual or corporation. There are, however, many exceptions to this principle which allow for taxation to be made, exclusively or concurrently, in accordance with the source principle. A summary of the key taxation rules for different types of income is provided as follows:

BUSINESS INCOME	
Business Profits	<p>Business profits are generally subject to the residency principle.</p> <p>However, profits deriving from a permanent establishment in the other jurisdiction shall be taxed in the jurisdiction where such establishment is located ². A comprehensive definition of permanent establishment is provided in article 5 of the DTRA.</p>
Shipping, Air and Land Transport	<p>The income deriving from the operation of ships, aircrafts or land transport vehicles shall be taxed only in accordance with the residency principle.</p>
Dividends, interest and royalties	<p>Dividends, interest and royalties are, in principle, taxed according to residency principle.</p> <p>However, dividends, interest and royalties may also be subject to taxation in the jurisdiction of the source of such income. Such taxation, however, is subject to a maximum 5% rate for interests and dividends and a 3% rate for royalties.</p> <p>In these situations, the residency jurisdiction should provide tax relief according to the methodology provided in article 23 (please see below).</p>

² For calculation of the profits attributed to the permanent establishment, the latter shall be considered as an independent unit from the entity it belongs to. Thus, the profit taken into consideration shall be the profit expected to be obtained by the permanent establishment in each of the jurisdiction as if it were a total distinct and separate entity.

	<p>The rules to implement the taxation limits provided in the DTRA are yet to be determined by the relevant Tax Authorities.</p>
<p>Capital Gains</p>	<p><u>Immovable assets</u></p> <p>Capital gains deriving from immovable property may be taxed in the jurisdiction where such property is located.</p> <p><u>Movable assets:</u></p> <p>Capital gains deriving from movable property which are part of a permanent establishment (including capital gains deriving from the sale of such business as an ongoing concern) or part of the business of an independent professional may be taxed in the jurisdiction where such establishment or business are located.</p> <p><u>Ships, aircraft or land transport vehicles</u></p> <p>Capital gains deriving from sale of ships, aircraft, land transport vehicles by entities who operate air, sea or land transportation businesses shall be taxable according to the residency principle.</p> <p><u>Shares and other similar interests</u></p> <p>Capital gains deriving from the transfer of shares or other comparable interests, including partnership interests and interests in any trusts may be taxed in the other jurisdiction if 50% or more of the value of the shares or such comparable interests, at any time during the 365 days before the transfer, is based directly or indirectly from the immovable property located in such other jurisdiction.</p> <p><u>Other assets</u></p>

Gains deriving from the transfer of other assets shall be taxable in accordance with the residency principle.

SALARIES AND INDEPENDENT PROFESSIONALS

Independent Professionals

Income obtained in respect of professional or otherwise independent services or shall only be taxable according to the residency principle, save as:

1. when the resident has a fixed base in other jurisdiction to provide its services; the income attributed to such fixed base may be taxed in accordance with the source principle; or
2. if the resident stays in the other jurisdiction for a period (consecutively or not) equal or more than 183 days during each fiscal year, the income derived from activities in such jurisdiction may be taxed according to the source principle.

Dependent Workers

Salaries, wages or other similar remuneration are taxable in accordance with the residency principle, except when the services are provided in the other jurisdiction, in which case the remuneration received therein may be taxed in accordance with the source principle.

Notwithstanding the services being provided in the other jurisdiction, the source principle does not apply if 3 requirements are cumulatively met:

- 1) If the individual does not spend more than 183 days during the relevant fiscal year in the jurisdiction where the services are provided;
- 2) The remuneration is paid by, or on behalf of, an entity that is not resident in the jurisdiction where the services are located; and
- 3) The remuneration is not borne by a permanent establishment or a fixed base held by the employer in the jurisdiction where the services are located.

<p>Directors' Fees</p>	<p>Directors' Fees and other similar payments may be taxed by the jurisdiction of residency of the company paying such remuneration.</p>
<p>Entertainers and Sportspersons</p>	<p>The income obtained by entertainers, such as actors, artists or musicians, and by sportspersons shall, in principle, be taxable in the jurisdiction where such activities are performed or exercised.</p>
<p>Pensions</p>	<p>Pensions payments and other similar remuneration (including a lump sum payment) payable as result of past employment or self-employment may be taxed in accordance with source principle.</p>
<p>Government Service</p>	<p>The salaries, wages and other similar remuneration, other than a pension, paid by the Government to individual in respect of services provided shall be taxable only in accordance with the source principle.</p> <p>However, such remuneration shall be taxable (only) in the other jurisdiction in the following circumstances:</p> <ul style="list-style-type: none"> - the services are provided in the other jurisdiction (i.e. in a different jurisdiction from that of the Government paying the remuneration); and - the individual is a resident of the other jurisdiction; and - the individual has the right of residency (abode) in the jurisdiction where the services are provided; or - the individual did not become a resident of the other jurisdiction solely for the purpose of providing the services.
<p>Professors and Researchers</p>	<p>When professors and academic researchers exercise their activities in an educational institution in a different jurisdiction from their residency, they are exempted from salaries tax in such jurisdiction for a period of three years in relation to the remuneration paid by, or on behalf of, an educational institution of their "home jurisdiction", provided that:</p>

- the individual is or was a resident of the home jurisdiction immediately before moving to the other jurisdiction; and
- the primary purpose for moving to the other jurisdiction was to teach or do research³.

<p>Students</p>	<p>When a resident of one of the parties moves to the other party (destination jurisdiction) with the sole purpose to continue his/her studies or training, he/she will be exempted from any taxation in the destination jurisdiction in relation to the income received to cover his/her expenses, provided such income is sourced outside of such jurisdiction.</p>
<p>PROPERTY INCOME</p>	
<p>Income from Immovable Property</p>	<p>Income may be subject to taxation on the jurisdiction where the property is located.</p>

³ Such exemption is not applicable to income obtained from research undertaken primarily for private benefit of a specific person or entity.

Methodology to avoid double taxation

Macau will apply the full exemption method, except in relation to income derived from dividends, interest and royalties, which will be subject to the ordinary tax credit method⁴, whereas Hong Kong will apply the ordinary credit methodology⁵.

The exemption method shall exempt from tax all income that, in accordance with the **DTRA**, the other Party has the right to tax. As result, Macau should provide a tax exemption both in relation to all income that Hong Kong has the exclusive right to tax and in relation to the income that *may* be subject to taxation in Hong Kong, irrespectively of such income having been effectively taxed therein.

The ordinary tax credit method will allow the residents of a party a tax deduction corresponding to the tax effectively paid in the other party up to the maximum amount payable as tax for such income in the first party. As result, Macau will provide its tax residents with a tax credit corresponding to the amount effectively paid in Hong Kong as (withholding) tax for income deriving from dividends, interests and royalties sourced in Hong Kong, up to the maximum tax that would be payable for such income in Macau.

Macau combines the exemption method with the tax credit method. While the implementation of tax exemption method will not create any issues, Macau internal legal system does not have any legal rules to implement the tax credit methodology. Those rules are yet to be produced to ensure how the tax credit is assessed, respective timing and how it may be effectively used by the taxpayer.

⁴ Article 23, paragraph 2 of the Hong Kong-Macau **DTRA**.

⁵ Article 23, paragraph 1 of the Hong-Kong Macau **DTRA**.

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Disclaimer: The above contents have a pure informational nature and do not constitute legal advice and cannot be relied upon as such. In particular, the summary of the rules relating to the allocation of taxation rights serve the purpose of highlighting the key rules and principles applicable and do not provide a complete analysis of such rules and exceptions.