
Hong Kong Special Administrative Region's Developing Double Tax Agreement Regime: A Case Study of the Hong Kong Special Administrative Region-New Zealand Double Tax Agreement

AIIFL Working Paper No. 7

September 2011

Asian Institute of International Financial Law
Faculty of Law
The University of Hong Kong
www.AIIFL.com



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HONG KONG SPECIAL ADMINISTRATIVE REGION'S DEVELOPING DOUBLE TAX AGREEMENT REGIME: A CASE STUDY OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION-NEW ZEALAND DOUBLE TAX AGREEMENT

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Abstract

This paper presents a case study analysis of the Hong Kong Special Administrative Region (HKSAR) - New Zealand (NZ) Double Tax Agreement (DTA) in the context of the DTA negotiating practices of the two jurisdictions. By way of background it first examines HKSAR's emerging DTA program and contrasts this with the approach to negotiating DTAs that is adopted by NZ. The paper concludes that the HKSAR-NZ DTA is an important milestone for the two jurisdictions, with the interplay with the People's Republic of China (PRC) a potentially challenging factor that needs to be incorporated into the practical ramifications of this new HKSAR-NZ DTA.

1. INTRODUCTION

Double taxation traditionally occurs when a taxpayer is taxed twice on the same income by two jurisdictions (source jurisdiction & residence jurisdiction). Relief is usually made on a unilateral basis (domestic laws) or a bilateral basis through double tax agreements (DTAs). The Hong Kong Special Administrative Region (HKSAR) is actively establishing a network of comprehensive DTAs (or more correctly Comprehensive DTAs is the term used in HKSAR (CDTAs) – hereafter this article will use DTA) with its major trading and investment partners (approximately 20 agreements have been reached although not all are in force). Where no comprehensive DTAs exist HKSAR has previously negotiated over 25 agreements for avoidance of double taxation on airline income, 6 agreements on shipping income (plus 2 agreements combining two areas). HKSAR is a destination for trade and investment, and seen as an attractive entry for many countries into the wider South East Asian economies. Also important to recognise is the HKSAR-New Zealand (NZ) Free Trade Agreement¹ that plays a major role in trade between the two jurisdictions. HKSAR is mounting a serious challenge to Singapore (which has over 60 DTAs) as a location to locate holding companies.

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¹ The New Zealand-Hong Kong, China Closer Economic Partnership Agreement (the "CEP") was signed in Hong Kong on 29 March 2010; see <http://www.mfat.govt.nz/downloads/trade-agreement/hongkong/NZ-HK%20CEP-final-copy1.pdf>.

In relation to HKSAR's rapid expansion of its DTA network, Previtiera, Boyle, and Kent (2011) observe:²

“The rapid expansion of Hong Kong's double tax agreement network is likely to create tax planning opportunities for global corporations with operations across Asia. Hong Kong is now a signatory of 17 DTAs, the most recent being the November finalization of a DTA with Japan and the December finalization of one with New Zealand. Although Singapore, with an extensive network of more than 60 treaties, is generally considered the most desirable holding company jurisdiction in Asia, Hong Kong is quickly mounting a serious challenge to Singapore's pre-eminence in this regard.”

The authors conclude with respect to HKSAR's positioning in this new era of an emerging comprehensive DTA platform:³

“Though many U.S. companies currently structure their Asian operations through Singapore, Hong Kong is rapidly emerging as a preferential alternative. With its growing DTA network, access to China's burgeoning marketplace, and favourable investment climate, Hong Kong presents strong commercial and tax justifications for making it the focal point of an Asian entity structure. Moreover, the enhanced operational and tax supply chain efficiencies that result from an Asian presence structured solely through Hong Kong creates added appeal. Global corporations should therefore remain cognizant of the opportunities resulting from Hong Kong's expanding DTA network.”

An important matter to consider before examining the HKSAR-NZ DTA is the position of NZ's DTA with the People's Republic of China (PRC). The PRC-NZ DTA was concluded in 1986 with effect from 1987,⁴ and updated by way of a protocol concluded in 2000. Does the DTA between NZ and the PRC extend to HKSAR? The answer is in the negative; the PRC-NZ DTA does not extend to HKSAR as the PRC-NZ DTA has a narrow definition of “China” for the purposes of the DTA.

Since the hand-over of HKSAR to the PRC in 1997, the PRC and HKSAR have been one country, although as noted earlier, HKSAR is a “special administrative district” of the PRC. The laws of the PRC will not apply to HKSAR for a period of 50 years following the 1997 hand-over. The relations

² P Previtiera, B Boyle and M Kent, “Optimizing Asian Operations through Hong Kong's Double Tax Agreement Network” (2011) 61 *Tax Notes International* (14 March) 859, at 859.

³ See n 2, at 863.

⁴ A copy of the PRC-NZ DTA is available from the NZ Inland Revenue Department's (NZIRD's) Policy Advice Division's website at: <http://taxpolicy.ird.govt.nz/tax-treaties/china>.

between the PRC and HKSAR are framed by the 1984 Sino-British Joint Declaration⁵ and by the Basic Law on Hong Kong,⁶ the latter being legislation promulgated by the PRC which became effective on 1 July 1997. The Sino-British Joint Declaration established the concept of “one country, two systems”, and guarantees maintenance of local rule for 50 years after the hand-over of HKSAR to the PRC in 1997. The PRC-NZ DTA defines “China” as meaning the PRC and includes the territory of the PRC in which the Chinese laws relating to taxation apply. Under the Basic Law on Hong Kong, the Chinese taxation laws do not apply to HKSAR, so the PRC-NZ DTA does not extend to include HKSAR.

This study is a case study of the HKSAR and NZ DTA. Case study research is often maligned and considered to be a non-scientific approach to undertaking research. Notwithstanding this view, case study research is used extensively in academic enquiry in traditional social science disciplines as well as practice-oriented fields, with the design and analysis considerations of prime importance, more so often than the description of events or the scenario under review (see Yin, 2003).⁷

HKSAR, and in particular its DTA with NZ, was chosen as a nation that has responded to the Organisation for Economic Cooperation and Development’s (OECD’s) focus on information exchange and negotiated sufficient agreements to move to the OECD’s white list. Specifically the purpose of this case study is to understand the HKSAR’s approach to negotiating DTAs, to contrast this with that for NZ, and to examine in the context of where they two practices coincide, namely the HKSAR-NZ DTA. Overall this analysis seeks to offer an important contribution to the emerging literature on HKSAR’s recent approach to negotiating DTAs, with particular focus on an important DTA that supports a trade and investment agreement between HKSAR and NZ.

The remainder of this paper is set out as follows. Section 2 examines HKSAR’s emerging DTA program, which is followed in section 3 with NZ’s approach to DTAs. Section 4 reviews the HKSAR-NZ DTA with section 5 comparing the HKSAR and NZ DTA approaches. Section 6 sets out the concluding observations.

⁵ See An Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the People's Republic of China on the Future of Hong Kong (1984), signed on 19 December 1984; available at: <http://www.hkbu.edu.hk/~pchksar/JD/jd-full1.htm>.

⁶ Basic Law of the Hong Kong Special Administrative Region of the People’s Republic of China (1990), in effect from 1 July 1997; available at: <http://www.basiclaw.gov.hk/en/index/>.

⁷ R K Yin, *Case Study Research: Design and Methods* (2003, 2nd ed. Vol. 5, Thousand Oaks, CA: Sage Publications).

2. HKSAR'S EMERGING DTA PROGRAM⁸

Prior to 2010 HKSAR had a comprehensive DTA with only 5 jurisdictions (Belgium, Thailand, Vietnam, Luxembourg and the PRC).⁹ Twelve DTAs were negotiated in 2010 (this includes the DTA with NZ). A further 5 DTAs commenced negotiations in 2010 or early 2011,¹⁰ and at the time of writing in early September 2011, the negotiations have yet to be finalised.

HKSAR's territorial tax regime (under which foreign-source income is generally exempt from HKSAR tax) has traditionally meant that the issue of double taxation in a cross-border context has generally not arisen for HKSAR's taxpayers. Consequently DTAs have not been high on the HKSAR Government's priority list. Furthermore, with HKSAR's low corporate tax rate, the absence of withholding tax on dividends and interest, an exemption for capital gains, and domestic law provisions restricting HKSAR's ability to release information to external parties, it is clear to see why many jurisdictions have not placed a high priority on concluding a DTA with HKSAR.

The major motivation for a change from HKSAR to seek to conclude DTAs (and arguably for other jurisdictions to enter into a DTA with HKSAR) is the January 2010 legislative enactment empowering the HKSAR Inland Revenue to obtain information requested by a DTA partner regardless of whether the HKSAR IRD has a domestic tax interest in the information.¹¹ The HKSAR Government previously took the view that the HKSAR IRD was unable, under domestic law, to obtain information in which it did not have a domestic tax interest. With finalisation, by the HKSAR Government in March 2010, of secondary legislation, all exchanges of information under DTAs will occur in accordance with procedures protecting the right of potentially affected HKSAR taxpayers to be informed of the proposed exchange and to challenge it if legal grounds exist for doing so.¹² On 9 June 2011 the HKSAR IRD issued Departmental Interpretation and Practice Notes No. 47 (DIPN 47), which sets out the HKSAR IRD's practices and administrative guidelines for processing an

⁸ The information on HKSAR's DTA program is largely drawn from the website of the Hong Kong Inland Revenue Department (HKIRD); see <http://www.ird.gov.hk/eng/tax/dta1.htm>.

⁹ The HKSAR-NZ DTA follows HKSAR's DTAs negotiated with Belgium, Thailand, The Peoples' Republic of China, Luxembourg, Vietnam, Brunei, the Netherlands, Indonesia, Hungary, Kuwait, Austria, the United Kingdom, Ireland, Liechtenstein, France and Japan.

¹⁰ Negotiations were pursued with Italy, the Czech Republic, Spain, Finland, and Switzerland.

¹¹ Inland Revenue (Amendment) Ordinance 2010 and the Inland Revenue Rules on exchange of information and the progress of treaty negotiations; these came into effect on 20 March 2010. This relates especially to the OECD's exchange of information provisions and has enabled, for example, the DTA with NZ to proceed – see Inland Revenue (Double Taxation Relief and Prevention of Fiscal Evasion with respect to Taxes on Income (New Zealand) Order 2011.

¹² See J VanderWolt, "Year in Review: Hong Kong" (2010) 60 *Tax Notes International* (December 10) 932.

exchange of information (EOI) request under a DTA and explains the safeguards available to taxpayers to protect their rights to confidentiality and privacy.¹³

This March 2010 legislative amendment can be attributed in a large part to pressure from the OECD on HKSAR such that HKSAR has amended its EOI laws and pledged to include strengthened EOI provisions in its future DTAs. With the signing of a sufficient number of DTAs, HKSAR would be removed from the OECD's gray list of countries that have not substantially implemented the OECD's internationally agreed tax standards, and be added to the white list. HKSAR, it would appear, narrowly avoided appearing on an OECD's blacklist, and was instead mentioned as a territory that is committed to implement the internationally agreed tax standard with respect to EOI.¹⁴

A consequence of HKSAR's actions is that they offer other jurisdictions an incentive to conclude a DTA with HKSAR.¹⁵ HKSAR needed to have 12 DTAs incorporating the updated OECD EOI standards in order to be considered as having adequately implemented the OECD's transparency and EOI standards. With HKSAR continuing to expand its DTA network (such as the DTA with NZ), at the time in writing it has concluded 17 DTAs and is thus well over the OECD's minimum requirement of 12 agreements. Importantly these DTAs incorporate the OECD's updated EOI standard (as set in 2004) and incorporated into the OECD's Model Tax Convention (2008).¹⁶

Ratification of DTAs under this new process is steadily being completed although most of these DTAs, at the time of writing, are yet to come into effect.¹⁷ HKSAR is seen as a desirable location for PRC investments and Singapore for the rest of Asia; this choice of options for investors raises the issues of compliance cost and efficiency in choice of business and investment location.

It is important to consider HKSAR's tax regime when examining its DTA policy, with key aspects of the HKSAR tax system comprising:

- Corporate tax rate of 16.5 percent;
- Purely territorial tax system (foreign-source income tax exempt, even if paid into HKSAR);

¹³ See HKSAR IRD website at: http://www.ird.gov.hk/eng/pdf/e_dipn47.pdf. See also by Y Law, D Yun, and S Li, "Hong Kong Issues Guidance on Information Exchange" (2010) 59 *Tax Notes International* (August 9) 415.

¹⁴ Lipsher comments in early 2010 that HKSAR was part black, part white making it in effect gray, as it had yet to conclude 12 DTAs, and even when it reaches that number it would still be a tax haven (like Singapore), even though neither country would wish to be called as such; see LE Lipsher, "Asian Tax review: Hong Kong: A Touch of Gray" (2010) 57 *Tax Notes International* (February 22) 679.

¹⁵ See further P Preveria and B Boyle, "Hong Kong-Japan Double Tax Agreement Ushers in a New Era" (2011) 61 *Tax Notes International* (January 10) 135.

¹⁶ OECD, *Model Tax Convention on Income and on Capital* (2008); updated to 2010.

¹⁷ See for example the state of DTA negotiations at <http://www.ird.gov.hk/eng/tax/dta1.htm>.

- Relatively low MTRs on individual income (on tier basis);
- One level of taxation of profits at corporate level (shareholder dividends not taxable);
- No withholding tax levied on interest or dividends paid to non-residents;
- 4.95 percent withholding tax levied on royalties paid to non-residents (a rate of 16.5 percent or 15 percent applies on royalties paid to an affiliate corporate entity or individual, respectively if the relevant intellectual property was formerly owned by an entity carrying on a business or trade in HKSAR);
- No capital gains tax;
- No VAT or goods and services tax; and
- Ability to carry forward losses indefinitely (but no carry-back provision).¹⁸

Following a high level review of HKSAR's DTAs that have been concluded, the following common characteristics (by way of key articles) are observable:¹⁹

- Scope of DTA;
- Taxes covered;
- Definition of permanent establishment;
- Dividend income;
- Interest;
- Royalties;
- Income from employment;
- Directors' fees;
- Airline or shipping profits;

¹⁸ See further M Littlewood, *Taxation without Representation: The History of Hong Kong's Troublingly Successful Tax System* (HKU Press, 2010); and M Littlewood, 'Tax System Design and the Instructive Case of Hong Kong' (2011) 63 *Tax Notes International* (July 18) 193.

¹⁹ See <http://www.ird.gov.hk/eng/tax/dta1.htm>.

- Business profits;
- Right to tax gains;
- Government payments;
- Income from immovable property; and
- Tax credit.

Of the main methods available to relieve double taxation HKSAR uses allowance of a tax credit.

3. NEW ZEALAND'S APPROACH TO DTAs

By way of background in understanding the NZ approach to DTAs, NZ largely follows the OECD's Model Tax Convention.²⁰ The works of White (2004), Smith (2010), Smith and Sawyer (2011) and Smith and Sawyer (2012)²¹ offer a comprehensive summary of the history of DTA policy in New Zealand, the extent to which New Zealand follows the OECD's Model Tax Convention, and relative influence of the OECD Model Tax Convention as compared to the United Nation's (UN's) Model Tax Convention.²² New Zealand has, since joining the OECD, has used the OECD's model for basis of treaty development, rather than the UN's model. That said in some instances NZ departs from the OECD Model Tax Convention where this suits its negotiating position, an approach that is not unique amongst OECD member countries.

New Zealand has a 'traditional' OECD member tax system with respect to a comprehensive worldwide liability for taxation of income using the residence principle, along with the liability for any income with a source in NZ. Exceptions to this include the absence of a capital gains tax (CGT)²³ and a 'pure' value-added tax (VAT), namely its goods and services tax (GST).²⁴ Currently NZ has 37 DTAs, 36 of which are in force (only the HKSAR-NZ DTA is yet to come into force).

²⁰ See n 16.

²¹ See: D White, *New Zealand's Double Tax treaty Policy and Practice: 1987 to 2004: A Preliminary Assessment* (2004); available at: <http://www.accountingeducation.com/subsites/fiscalpublications/globalchallenges/nzdttpolicypracticerevised.pdf>;

A Smith, "A History of New Zealand's Double Tax Agreements", (2010) 16(1) *New Zealand Journal of Taxation Law and Policy*, 105, A J Sawyer, and AMC Smith, "The Impact of OECD Membership upon New Zealand's International Tax Policy and DTA Negotiations" (2011) *Journal of the Australasian Tax Teachers Association*, forthcoming; and AMC Smith and AJ Sawyer, "National Report: New Zealand" in Lang, M. (ed) *The Impact of the OECD and the UN Model Conventions on Bilateral Tax Treaties*, (Linde, The Netherlands, 2012), forthcoming.

²² United Nations, *Model Double Taxation Convention between Developed and Developing Countries* (2011 update).

²³ New Zealand does tax some of its capital gains as ordinary income through the Income Tax Act 2007.

²⁴ For an excellent discussion and review of the first twenty years of the GST, see R Krever and D White, *GST in Retrospect and Prospect* (Brookers, 2007).

The NZ Government's view is to have a modest size network of (40-50 DTAs, a similar number to the United States and Japan) rather than around 100 (like the United Kingdom and Canada).

At the 2010 New Zealand Institute of Chartered Accountants' (NZICA) National Tax Conference, the Minister of Revenue, Peter Dunne, commented on the NZ Government's treaty policy as part of his address.²⁵ Regarding HKSAR, Mr Dunne observed:²⁶

“The economic case for a DTA with Hong Kong, one of the main financial and trading centres of Asia-Pacific, is obvious. Until recently, Hong Kong would not enter into exchange of information arrangements acceptable to us and other OECD countries. However, that has now changed, and Hong Kong is certainly a priority for us, as it is now for many other countries.”

Sawyer (2011) observes that NZ's DTA negotiating strategy, as stated by Mr Dunne, recognises DTAs come at a cost, such that:²⁷

- Revenue is forgone;
- They lock in positions affecting tax policy;
- Interpretations vary between agreements and treaty partners; and
- One must update as changes occur with the OECD Model Tax Convention or when a country negotiates new treaties.

Furthermore, a DTA must also be meaningful to NZ if it will agree to enter into negotiations with a particular jurisdiction. This means:

- A significant economic relationship must exist;
- Real double tax issues must exist; and
- Advantages for information exchange warrant the associated obligations under a DTA.

A further part of NZ's policy with respect to DTAs is that it will undertake a cost/benefit analysis to prioritise which jurisdictions NZ wishes to enter negotiations with, although NZ must recognise its

²⁵ Hon. P. Dunne, *Keynote address to the 2010 NZICA Tax Conference* (Auckland, Oct. 29, 2010); available at <http://taxpolicy.ird.govt.nz/news/2010-10-29-nzica-conference>.

²⁶ See n 25.

²⁷ See A Sawyer, 'Highlights of the Hong Kong-New Zealand DTA', (2011) 61 *Tax Notes International* (31 January) 377.

desire to enter negotiations as a result of this analysis need to be in line with the potential negotiating partner jurisdiction.

4. THE HKSAR-NZ DTA

The HKSAR-NZ DTA (an agreement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income) is the seventeenth for HKSAR DTA and the thirty seventh (and most recent at the time of writing) for NZ.²⁸ Overall this DTA is expected to boost cross-border trade and investments once it comes into force (this is likely to be by late 2011 with application from 1 April 2012). The DTA was negotiated and signed in just a few months – an extremely quick period in the context of DTA negotiations which usually take several years. HKSAR is NZ's ninth largest export market (NZ exports worth \$NZ850 million pa - \$HK5,610 million pa), making it a key jurisdiction and meaningful to NZ's economic future.

On 1 December 2010, the Financial Secretary for HKSAR, Mr John C Tsang, signed the HKSAR-NZ DTA in Auckland, NZ on behalf of the HKSAR Government. The NZ Deputy Prime Minister and Minister of Finance, Mr Bill English, signed on behalf of the NZ Government. Mr Tsang welcomed the agreement as further strengthening the bilateral relationship by encouraging the flow of investment and talents between HKSAR and New Zealand.²⁹

When the HKSAR-NZ DTA comes into force, it will supersede the existing limited double taxation avoidance agreement between HKSAR-NZ for airline income, providing the same level of benefit. The level of benefit in the existing reciprocal exemption on shipping income will also remain the same.³⁰

²⁸ A copy of the HKSAR-NZ DTA is available at both the HKSAR and NZ Inland Revenue websites: http://www.ird.gov.hk/eng/pdf/Agreement_New_Zealand_HongKong.pdf; and <http://taxpolicy.ird.govt.nz/tax-treaties/hong-kong>; respectively. A Protocol is included with the agreement providing further interpretation with respect to particular articles in the DTA, including international shipping and air transport, dividends, interest, pensions, exchange of information and entry into force. Article 4 of the protocol is particularly interesting. It states:

4. With reference to Article 24:

- (a) it is understood that the Article does not require the Contracting Parties to exchange information on an automatic or a spontaneous basis; and
- (b) the New Zealand competent authority may disclose information to the Office of the Ombudsmen in the investigation of complaints against the administrative actions of the New Zealand Inland Revenue Department.

²⁹ See HKSAR Press Release, *Hong Kong New Zealand Sign Tax Pact*, (1 December 2010); available at: <http://www.ird.gov.hk/eng/ppr/archives/10120101.htm>. See also the NZ IRD Press Release, IRD, *New Zealand-Hong Kong tax agreement signed* (1 December 2010); available at: <http://taxpolicy.ird.govt.nz/news/2010-12-01-hong-kong-dta-signed>.

³⁰ NZ has reciprocal arrangements with HKSAR for both international shipping and international aircraft operations; see further NZ IRD Policy Advice Division website at: <http://taxpolicy.ird.govt.nz/tax-treaties>.

The HKSAR-NZ DTA follows the Closer Economic Partnership Agreement (CEPA) – in effect the basis for HKSAR’s Free Trade Agreement with NZ, which came into force 1 January 2011, with the investment protocol in the process of finalisation as at the time of writing in September. This is the first such agreement after HKSAR’s CEPA with the PRC. In reviewing the HKSAR-NZ DTA is similar to other recent NZ DTAs (including the recent 2009 Australia-NZ DTA that replaces the earlier 1995 Australia-NZ DTA and the recent protocol (operative from 2010) to the 1982 NZ-United States DTA).³¹

The HKSAR-NZ DTA is expected to come into force in 2011, with application from 2012. HKSAR gazetted its order in May 2011 (Inland Revenue (Double Taxation Relief and Prevention of Fiscal Evasion with respect to Taxes on Income (New Zealand) Order 2011). New Zealand expects to ratify by end of 2011 released August 2011).³²

The key highlights of the HKSAR-NZ DTA include:³³

- The DTA applies to individuals ordinarily resident in NZ or HKSAR, and companies (and other entities) that are tax resident in NZ or incorporated in HKSA. For entities that are not incorporated in HKSAR, the DTA applies to those that are “normally managed or controlled in” HKSAR. The latter approach is due to HKSAR not having a domestic concept of corporate or entity tax residence;
- Under the DTA, double taxation will be avoided. Any NZ tax paid by the companies will be allowed as credit against the tax payable in HKSAR regarding the income, subject to the provisions of the tax laws of HKSAR;
- Under the permanent establishment article in the DTA, there is a 183-day rule (in any 12-month period) for operation of substantial equipment and activities that contribute substantially (more than 50 percent) to gross revenues of a project. This is similar to the provisions in the 2009 Australia-NZ treaty;
- Also under the PE article, a PE will arise if an independent agent habitually exercises or has authority to conclude contracts for an enterprise (in the other state). This contrasts with recent

³¹ The texts of these DTAs are available from the IRD’s Policy Advice Division website at: <http://taxpolicy.ird.govt.nz/tax-treaties>.

³² See Inland Revenue (NZ), *National Interest Analysis: Double Tax Agreement with the Hong Kong Special Administrative Region of the People’s Republic of China*; available at: http://www.parliament.nz/NR/rdonlyres/620556B5-0AD9-42AC-AFFF-28A0A99689CA/199270/DBSCH_ITR_10791_Internationaltreatyexaminationofth.pdf.

³³ See Sawyer, above n 27, at 378.

updates to NZ's other treaties, which explicitly include circumstances in which the agent "substantially negotiates" contracts on behalf of the other party; and

- The HKSAR_NZ DTA contains comprehensive exchange of information provisions, incorporating the latest standards on exchange of information.

Another aspect of the HKSAR-NZ DTA is that it includes an exemption for international shipping.

In terms of the rates provided for dividends, interest and royalties, Table 1 sets out the rates as negotiated in the HKSAR-NZ DTA. These rates are similar to those included in recent DTAs that NZ has negotiated with other jurisdictions.

Table 1: Withholding Tax Rates on Dividends, Interest and Royalties under the NZ-HKSAR DTA

Income	Withholding tax rate under DTA
Interest	10% 0% – interest paid to a financial institution (third party loans only and Approved Issuer Levy (AIL) must be paid or be payable)
Dividends	15% – Less than 10% shareholding 5% – 10% to 50% shareholding (if the recipient is a company) 0% – 50% or greater shareholding and other requirements met (e.g. recipient is a company and listed and primarily traded on a recognised NZ or HK Stock Exchange)
Royalties	5%

The National Interest Analysis from NZ revenue officials with respect to the HKSAR-NZ DTA concludes the following to be advantages:³⁴

- Foster bilateral economic activity (such as services, trade and investment). DTA will complement the CEPA and investment protocol to that Agreement;

³⁴ See n 32 above.

- Reduce compliance costs and ensuring availability of low headline withholding tax rates;
- Reduced withholding tax rates for dividends that are not fully-imputed and royalties;
- Reduce the cost of importing capital;
- Prohibit discriminatory taxes;
- Provide a mutual agreement procedure to facilitate the resolution of tax disputes;
- Eliminate need for individuals engaged in certain short-term, income-earning activities to pay tax and claim that tax against the tax liability in the individual's home jurisdiction;
- Provide an equitable framework for sharing the cost of relieving double taxation; and
- Eliminate the need for NZ to provide credits for certain foreign taxes.

The disadvantages are seen to be that the HKSAR-NZ DTA:

- provides that: (a) certain lump sum retirement payments from HKSAR will be taxable only in HKSAR; and (b) the taxing right on some periodic government service pensions will be shared by both jurisdictions; and
- allows for potential treaty-shopping³⁵ concerns. Since HKSAR is a significant international financial centre, and has a territorial-based tax system, HKSAR is a favoured location for non-residents to establish companies and take advantage of special concessions available in HKSAR.

The HKSAR-NZ DTA is a compromise between the starting positions of NZ and HKSAR; from NZ's perspective its key negotiating objectives were secured. A key area of compromise is the taxation of pensions.

Officials are satisfied potential advantages to NZ outweigh potential disadvantages. A major advantage is to avoid double taxation for NZ resident taxpayers. There is minimal cost in lost revenue (\$NZ0.5m - \$HK3.4 million) according to the analysis, which is not surprising given the narrow scope of HKSAR's tax regime to non-residents. Various changes to NZ domestic law via treaty override are required, although this is standard with respect to any negotiated DTA. The

³⁵ Treaty shopping is considered to be is the inappropriate use of tax treaties by residents of third states. More specifically it includes transactions that involve the establishment of entities or residency in a particular jurisdiction to permit a taxpayer to avail itself of the benefits of a treaty with the particular jurisdiction for tax avoidance purposes.

analysis is wider than merely economical matters, with the analysis concluding that no social, cultural or environmental effects are foreseen. Importantly the compliance costs for businesses are expected to reduce with the HKSAR-NZ DTA in place.

Limited consultation was undertaken in the process, which is not uncommon given the sensitive nature of DTA negotiations. The analysis indicates that other relevant NZ Government Departments and Ministries were involved, along with HCSB, prior to the DTA negotiations.

5. COMPARISON OF HKSAR AND NZ DTA APPROACHES

What can we observe from this case study analysis of the HKSAR-NZ DTA, as set within the context of the DTA negotiation approaches in the two jurisdictions? HKSAR is in rapid expansion phase with change in philosophy following 2010 legislative amendment facilitating greater information exchange. HKSAR is keen to be a major entry point for South East Asia, especially for entry to the PRC. To this end establishing a treaty network is seen to be a key element. New Zealand is a key partner being the first to have a FTA with HKSAR outside of that of HKSAR's agreement with PRC.

New Zealand has been steadily increasing its DTA network over last 4 to 5 years – it is aiming to grow to between 40-50 agreements with its major trading partners. The National Interest Analysis indicates that there must be clear benefits to NZ if it will negotiate a DTA and it will undertake cost/benefit analysis before and during negotiations. As prior research indicates, NZ largely follows the OECD Model Tax Convention with its DTAs.

As a consequence of their relative stages of development with their DTA policies, HKSAR is in a period of rapid progression to negotiate agreements, in effect an attempt to catch up with other major jurisdictions and to reflect the expectations of the OECD with respect to jurisdictions that have traditionally been classed as 'tax havens'. Just how many agreements HKSAR is seeking to negotiate before it reduces the pace of negotiations and moves into a 'steady state' remains unknown at this time. New Zealand, on the other hand, has a more extensive array of DTAs and is continuing on with a steady program of negotiating DTAs with jurisdictions that are important to NZ's economic and trade future.

The HKSAR-NZ DTA represents the interaction of two DTA negotiating strategies coming together at an important time for HKSAR as it seeks to expand its DTA network with common law jurisdictions. From NZ's perspective the HKSAR-NZ DTA demonstrates that NZ can indeed negotiate a DTA rapidly, with the ratification process a different matter, reflecting its bureaucratic and complex series of steps.

6. CONCLUDING OBSERVATIONS

What can we draw from the earlier discussion in this case study of the HKSAR-NZ DTA? A unique aspect of HKSAR's DTA program is that NZ is the only country currently outside of the PRC to have a FTA in place, although some parts of this FTA have yet to become operative. HKSAR is becoming a major alternative or complement to Singapore as a hub for investment into South East Asia. This is an important matter for investors to ascertain which jurisdiction may be preferable to locate their business activities. In comparison to HKSAR, NZ has a much larger DTA network; its aim is to reach between 40-50 agreements over the next few years.

HKSAR's new approach to negotiating DTAs should consolidate its role as a 'responsible global player' in the international arena (as viewed by the OECD) and transform its business landscape by providing greater tax benefits and certainty for cross-border businesses. The HKSAR-NZ DTA will add to this environment.

While NZ follows the OECD Model Tax Convention there are some differences to account for the tax system in HKSAR and NZ's negotiating position on several key articles in the HKSAR-NZ DTA. Furthermore, the HKSAR-NZ DTA is one from both HKSAR and NZ perspectives to be mutually beneficial for the respective governments and businesses. If this were not the position it would be very unlikely that the agreement would have been concluded, and for that matter concluded in such a quick period of time. The HKSAR-NZ DTA should facilitate trade and investment flows between the two jurisdictions and potentially into the PRC. One potential inhibitor to such expansion into the PRC is the current state of the PRC-NZ DTA.

The New Zealand China Trade Association (NZCTA) has suggested that with the conclusion of the HKSAR-NZ DTA, it is now time to revisit the PRC-NZ DTA that came into force in 1996 and was updated by protocol in 2000. Specifically the NZCTA stated:³⁶

“Hopefully the [New Zealand] Government will also move up a gear and enter into renegotiations with China to update [its] Double Tax Treaty. Given [New Zealand's] model Free Trade Agreement with China and also the growing importance of China to New Zealand, it is high time this is given priority status, and with the significant changes to the tax world since 1986 it is critical [New Zealand] step into gear and ensure [its] double tax treaties with major trading partners are up to date.”

³⁶ See NZCTA, “What the HK Double Tax Agreement Means for You” (2010); available at <http://www.nzcta.co.nz/chinanow-finance/1218/what-the-hk-double-tax-agreement-means-for-you/>.

Whether the PRC-NZ DTA is to be updated further is not able to be ascertained as there have not been any public announcements regarding this DTA at the time of writing (renegotiations are underway with Canada and the United Kingdom, and potentially with Papua New Guinea).³⁷ HKSAR has ratified the DTA; NZ has yet to do so but should before the end of 2011, with the agreement taking effect by 1 April 2012.

An area warranting further research is the role that the PRC-NZ DTA, and the arrangements between HKSAR and the PRC may play in the practical operation of the HKSAR-NZ DTA. When the HKSAR-NZ DTA becomes operative this third link to the bilateral relationship is expected to rise to the forefront of debate.

³⁷ As at July 2011 China does not feature on the overview provided on the NZ Ministry of Foreign Affairs website regarding DTAs: see <http://www.mfat.govt.nz/Treaties-and-International-Law/03-Treaty-making-process/1-International-Treaties-List/16-Double-Tax-Agreements.php>.