REFLECTIONS ON THE DTA

A double taxation agreement (DTA) between Switzerland and Hong Kong, signed on October 4, 2011, will enter into force soon. This DTA replaces a previous double taxation agreement signed on December 6, 2010. Although most of the wording from the initial agreement remains the same, the clause regarding the exchange of information has been adjusted to be in line with the latest standards of the Organization for Economic Co-operation and Development (OECD).

Double taxation agreements apply to persons who are residents of one or both of the contracting states and this DTA follows the same principle. In this case, this principle applies mainly to Switzerland, since the sole residence criterion under the DTA is not necessarily sufficient to establish a tax residence nexus in Hong Kong. Without such nexus the Inland Revenue Department is not entitled to levy taxes since Hong Kong abides by the territoriality basis of taxation, whereby only income or profit sourced in Hong Kong are subject to tax. Consequently, for the purposes of this DTA, it was necessary to specify further criteria, in order to distinguish between residents and non-resident persons in Hong Kong. According to the DTA, an individual is a resident of Hong Kong if the individual ordinarily resides in Hong Kong or such an individual stays in Hong Kong for more than 180 days during the year of assessment or for more than 300 days in two consecutive years. When it comes to companies they are resident of Hong Kong if they have been incorporated in Hong Kong, or if incorporated outside Hong Kong they are normally managed and controlled in Hong Kong.

Double taxation agreements may address various areas of taxation such as income taxes, inheritance taxes, or other taxes. They serve primarily to mitigate the effects of double taxation which might be suffered when income is paid overseas and two or more states try to tax the same revenue twice or more. Double taxation might also occur when elements of passive income such as dividends, interest, or royalties are paid overseas. Generally the state of source tries to levy a withholding tax, while the other state tries to tax the same revenue a second time, and many different scenarios are possible. For example, Hong Kong does not levy in principle a withholding tax on dividends and interests, while a limited burden is suffered with

regard to royalties. Conversely, Switzerland does not levy any withholding tax on royalties but perceives one on bank interest and interest on bonds, as well as on dividends. One of the benefits of this DTA is that such withholdings might be reduced to nil. Another salient feature under this DTA is a stringent limitation on the benefits provision introduced with regards to dividends, interest, and royalties. Such a limitation aims at tackling issues where taxpayers residing outside Hong Kong would be tempted to invest in Switzerland through Hong Kong-based companies, solely for the purpose of taking advantage of benefits of this DTA.

While the wording of this DTA has not been profoundly modified in comparison to the version initially signed on December 6, 2010, the provision on the exchange of information has seen the highest amount of amendments. The protocol signed by both territories specifies that an exchange of information shall only be requested once all regular sources of information under the internal taxation procedure have been exhausted. The introduction of such limitations aims at avoiding "fishing expeditions" while safeguarding the privacy of taxpayers. In addition to rules laid down with regard to the exchange of information, the DTA deals also with the secrecy of the information disclosed. Information exchanged is restricted to corresponding tax authorities and no disclosure is admitted to oversight authorities.

Nathan Kaiser is a senior partner at Eiger Law and has over 12 years of professional legal experience in Taipei, Hong Kong, Beijing and Shanghai, advising clients on corporate, commercial, investment and tax law.

Kristian Olenik (LL.M) holds degrees from the Universities of Neuchâtel, Lausanne and Vienna. He is also a certified Swiss IAF®-fund advisor. Kristian has worked on a variety of corporate transactions, including taxation, setting up of entities, plus commercial agreements.