

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2017

PAPER 2.04 – HONG KONG OPTION

ADVANCED INTERNATIONAL TAXATION (JURISDICTION)

TIME ALLOWED – 3¼ HOURS

This paper has **three** parts: **Part A**, **Part B** and **Part C**.

You need to answer **five** questions in total.

You must answer:

- **Both** questions in **Part A** (25 marks each)
- **The** question in **Part B** (20 marks)
- **Two** questions from **Part C** (15 marks each)

Further instructions

- All workings should be made to the nearest month and in Hong Kong Dollars, unless otherwise stated.
- Start each answer on a new page and clearly indicate which question you are answering. If you are using the on-screen method to complete your exam, you must provide appropriate line breaks between each question, and clearly indicate the start of each new question using the formatting tools available.
- Marks may be allocated for presentation.
- The time you spend answering questions should correspond broadly to the number of marks available for that question. You should therefore aim to spend approximately half of your time answering Part A, and the other half answering Parts B and C.
- The first 15 minutes of the exam consists of reading time. You will be allowed to annotate the question paper during this time; however, you will **not** be permitted to start writing or typing your answer, or use a calculator. The Presiding Officer will inform you when you can start answering the questions.

For your information this paper includes:

- **Appendix: Agreement between Mainland China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation (Extracts)**

Tax Rates and Allowances

| Year of Assessment | <u>2016/17</u> |
|--|----------------|
| <u>Tax Rates</u> | |
| Standard rate | 15% |
| Corporate profits tax rate | 16.5% |
| Progressive rates | |
| First \$40,000 | 2% |
| Next \$40,000 | 7% |
| Next \$40,000 | 12% |
| Remainder | 17% |
| <u>Tax Reduction</u> (where applicable) | |
| Percentage of reduction | 75% |
| Maximum per case | \$20,000 |
| <u>Personal Allowances</u> | |
| | \$ |
| Basic | 132,000 |
| Married person's | 264,000 |
| Child – 1 st to 9 th (each) | 100,000 |
| Additional (for year of birth, each) | 100,000 |
| Dependent parent / grandparent (each) | |
| Basic | 46,000 |
| (aged 55 or above but below 60: \$23,000) | |
| Additional | 46,000 |
| (aged 55 or above but below 60: \$23,000) | |
| Dependent brother / sister (each) | 33,000 |
| Single parent | 132,000 |
| Disabled dependent (each) | 66,000 |
| <u>Deductions</u> (maximum limits) | |
| Self-education expenses | 80,000 |
| Elderly residential care expenses | 92,000 |
| Home loan interest | 100,000 |
| Contributions to MPF/recognized retirement schemes | 18,000 |

Depreciation Allowance

Plant and machinery

Initial – 60%

Annual – Air-conditioning plant: 10%

Furniture and fixtures, office equipment, room air-conditioning unit,
domestic appliance, packaging machine: 20%

Motor vehicle, electronic data processing equipment (computer),
manufacturing machine, production mould: 30%

Industrial building

Initial – 20%

Annual – 4% or formula

Commercial building

Annual – 4% or formula

Stamp Duty rates

Ad valorem Stamp Duty

Effective 23 February 2013, Scale 1

Consideration (round up to nearest \$1)

| <u>Consideration (round up to nearest \$1)</u> | <u>Rate</u> |
|--|---|
| Up to \$2,000,000 | 1.5% |
| \$2,000,001 - \$2,176,470 | \$30,000 + 20% of excess over \$2,000,000 |
| \$2,351,761 - \$3,000,000 | 3% |
| \$3,000,001 - 3,290,330 | \$90,000 + 20% of excess over \$3,000,000 |
| \$3,290,321 - \$4,000,000 | 4.5% |
| \$4,000,001 - \$4,428,580 | \$180,000 + 20% of excess over \$4,000,000 |
| \$4,428,571 - \$6,000,000 | 3% |
| \$6,000,001 - \$6,720,000 | \$360,000 + 20% of excess over \$6,000,000 |
| \$6,720,000 - \$20,000,000 | 7.5% |
| \$20,000,001 - \$21,739,130 | \$1,500,000 + 20% of excess over \$20,000,000 |
| Over \$21,739,130 | 8.5% |

Effective 23 February 2013, Scale 2

Consideration (round up to nearest \$1)

| <u>Consideration (round up to nearest \$1)</u> | <u>Rate</u> |
|--|---|
| Up to \$2,000,000 | \$100 |
| \$2,000,001 - \$2,351,760 | \$100+ 10% of excess over \$2,000,000 |
| \$2,351,761 - \$3,000,000 | 1.50% |
| \$3,000,001 - 3,290,320 | \$45,000 + 10% of excess over \$3,000,000 |
| \$3,290,321 - \$4,000,000 | 2.25% |
| \$4,000,001 - \$4,428,570 | \$90,000 + 10% of excess over \$4,000,000 |
| \$4,428,571 - \$6,000,000 | 3% |
| \$6,000,001 - \$6,720,000 | \$180,000 + 10% of excess over \$6,000,000 |
| \$6,720,000 - \$20,000,000 | 3.75% |
| \$20,000,001 - \$21,739,120 | \$750,000 + 10% of excess over \$20,000,000 |
| Over \$21,739,120 | 4.25% |

Effective 5 November 2016, all residential property: 15%, unless exemption or relief applies.

Special Stamp Duty (SSD)

| Property which has been held for | <i>Acquired on or after 27 October 2012</i> |
|---|---|
| 6 months or less | 20% |
| > 6 months but 12 months or less | 15% |
| > 12 months but 36 months or less | 10% |

Buyer's Stamp Duty (BSD): 15%

Head 1(2)

| <u>Term of lease</u> | <u>Rate</u> |
|--------------------------|---|
| Not defined or uncertain | 0.25% of yearly or average yearly rent |
| Not exceeding 1 year | 0.25% on total rent payable over lease term |
| Between 1 to 3 years | 0.5% on yearly or average yearly rent |
| Exceeding 3 years | 1% on yearly or average yearly rent |

Head 2(1)

| <u>Nature of Document</u> | <u>Rate</u> |
|---|--|
| Contract Note for sale or purchase of any Hong Kong stock | 0.1% of the amount of the consideration or of its value on every sold note and every bought note |
| Transfer operating as a voluntary disposition inter vivos | \$5 + 0.2% of the value of the stock sold |
| Transfer of any other kind | \$5 |

PART A

You are required to answer BOTH questions from this Part.

1. Rose Ltd (RL) is incorporated in Hong Kong and has been carrying on a business of distribution of supplements and organic fruits in Hong Kong for a number of years. During the year ending 31 December 2015, RL established ten wholly-owned subsidiaries in various mainland Chinese cities to promote its products to customers. The subsidiaries act on behalf of RL, engage with customers and finalise the trading terms, although no formal agency agreement has been signed between RL and the mainland subsidiaries.

Upon conclusion of the trading terms, customers in mainland China place orders with the subsidiaries, which then forward the orders on to RL. Having received orders from the mainland subsidiaries, RL places the orders with Dandillion Ltd (DL), a Hong Kong company wholly owned by RL. Afterwards, DL place corresponding orders to ultimate suppliers in Europe via email. The goods are delivered directly from Europe to the customers. RL pays a service fee of 5% to the mainland subsidiaries on sales obtained by the subsidiaries.

During 2016, RL's marketing managers travelled to the mainland to promote RL's business. They met with some of the customers at the mainland subsidiaries' offices, as RL does not directly own or rent any office premises in mainland China.

You are required to:

- 1) Discuss the Hong Kong profits tax implications to RL in relation to profits derived from China customers. (12)**

RL has reported all profits derived from its sales in mainland China as taxable in China, and the Hong Kong Inland Revenue Department has acknowledged the profits derived from customers in mainland China as offshore and non-taxable.

However, in early 2017 the Chinese tax authority initiated a tax audit and opined that the profits expenditure allocation bases between the mainland China trading business and other RL businesses are not reasonable. Consequently, the Chinese tax authority has adjusted upward the profit derived from sale to China customers.

- 2) How should RL respond to this transfer pricing adjustment? (13)**

Total (25)

2. Berry and Ally Ltd (BAL) is incorporated in Country B, which has not signed a tax treaty with mainland China. BAL holds 100% shareholding in a Hong Kong company, Berry HK Ltd (BHK), which is engaged in brokerage business. BHK manages investment funds on behalf of its clients, and receives income in the form of commission. BHK's management has recently entered into a cooperation agreement with a company in mainland China, Mary Company (MC), whereby BHK and MC will set up a joint venture company in Guangzhou, China. BHK and MC each hold 50% of shares in the joint venture company, Green Apple Company (GAC).

In addition to its brokerage business, BHK has developed a computer programme able to interact with databases owned by other overseas companies. The programme, which is named "Big Data Extraction Expert System" (BDEES), extracts data and prepare financial reports according to the requirements specified by the clients. BHK pays content usage fees to other overseas companies for the right to assess and extract data from their databases, either by itself or by its designated companies. The content usage fee totals 3% of the commission or royalty income generated through the extraction and use of the data.

BHK intends to grant GAC the right to use BDEES in return for a royalty of 5% of GAC's turnover. A BHK technician will assist GAC in configuring GAC's computer systems to operate BDEES. BHK will also provide on-site BDEES technical support at GAC's Guangzhou office.

For the year ending 31 December 2017, it is expected that GAC will distribute a dividend of RMB 1 million to BHK. BHK will distribute all dividends received from GAC to BAL.

BAL's management plans to maintain the investment held in GAC via BHK for three years. Upon expiry of the investment period, BHK will dispose of 5-10% of its shareholding in GAC if an attractive offer is received at that time.

You are required to:

- 1) **State the conditions under which a Hong Kong resident company would be subject to Enterprise Income Tax (EIT) in mainland China, in accordance with the Double Taxation Arrangement (DTA) between mainland China and Hong Kong.** (4)
- 2) **Analyse the Chinese EIT implications, in the context of the DTA only, of BHK's arrangement with GAC regarding BDEES.** (7)
- 3) **Analyse the Hong Kong profits tax implications of BHK's arrangement with GAC in relation to BDEES. Your answer should include arguments for and against the taxability of the royalty received from GAC.** (8)
- 4) **Analyse the Chinese EIT implications (in the context of the DTA only), and the Hong Kong profits tax implications, of the dividends paid by GAC to BHK and by BHK to BAL.** (3)
- 5) **Analyse the Chinese EIT implications (in the context of the DTA only), and the Hong Kong profits tax implications, of BHK's planned disposal of GAC shares.** (3)

Total (25)

PART B

You are required to answer THIS question.

3. Bale Company Ltd (BC) is a company resident in mainland China, which is engaged in the manufacture and trade of smartphones, tablets and various computer products. BC distributes products through its well-established distribution network in China. In order to streamline its production, BC undertook a reorganisation two years ago. Two new companies were established to conduct the marketing and advertising of BC's products: one for the mainland China market and the second, Chris & Chris Ltd (CCL), for the Hong Kong market.

BC retains responsibility for all work relating to the manufacture of its products, including the sourcing of raw materials, research and development, and quality control. CCL purchases goods from BC for retail and distribution in Hong Kong.

Due to the effectiveness of its marketing and production strategies, the group has performed very strongly in the two years since the reorganisation, and has outperformed its competitors. BC and CCL believe it was their highly integrative approach to marketing and manufacturing which drove the growth of the two companies. BC is entitled to tax incentives in mainland China, and its current income tax rate is 12.5%.

For accounting purposes, BC has sold goods to CCL at its production cost plus a 30% mark-up. The management of BC and CCL are anxious that the existing pricing method might not be acceptable to the Hong Kong Inland Revenue Department, as CCL's profit was three times of that of BC during the two years since the reorganisation.

You are required to:

- 1) Explain all types of transfer pricing adjustment method available, and their applicable circumstances according to the practice of the Hong Kong Inland Revenue Department. (16)**
- 2) Determine which transfer pricing method is most applicable to BC and CCL in view of their present situation, and explain why. (4)**

Total (20)

PART C

You are required to answer TWO questions from this Part.

4. Peter Ltd (PL) is a Hong Kong-based company and carries on a property investment and general trading business. PL is owned by Mr and Mrs Huang, who are both resident in mainland China and each hold a 50% stake in PL.

On 1 December 2016, PL carried out a restructuring exercise and transferred all of its properties to a newly incorporated property holding subsidiary company in Hong Kong, Aaron Ltd (AL). PL owned 80% shares in AL, while Mr and Mrs Huang each individually owned a further 10% in AL. Agreements for sale were signed for the property transfer transactions. Mr and Mrs Huang believed that the property transactions should be exempt from Stamp Duty in Hong Kong because the properties were transferred from a holding company to its subsidiary.

Details of the properties transferred from PL to AL are as follows:

| <u>Property</u> | <u>Acquisition date</u> | <u>Nature</u> | <u>Market value</u> <u>(HK\$)*</u> | <u>Transfer value</u> <u>(HK\$)</u> |
|-----------------|-------------------------|---------------|---------------------------------------|--|
| 1 | 1 April 2013 | Residential | 8,000,000 | 7,000,000 |
| 2 | 1 March 2013 | Shop | 10,000,000 | 11,000,000 |
| 3 | 1 May 2015 | Residential | 22,000,000 | 20,000,000 |
| 4 | 1 November 2015 | Residential | 9,000,000 | 11,000,000 |

No market valuation was conducted at the time of each property's transfer. The market valuation was completed recently, when PL hired a new Finance Director, Mr Wong. Mr Wong is concerned about the Stamp Duty implications of these transactions.

You are required to:

- 1) **Briefly discuss whether any relief is available in relation to PL's restructuring exercise.** (3)
- 2) **Analyse the Stamp Duty liability pertaining to the restructuring exercise, if no relief is available.** (12)

Total (15)

5. DBC Ltd (DBC) carries on a general trading business in Hong Kong. In preparing DBC's tax computation for the year ending 31 December 2016, DBC's accountant, Mr Philips, noticed the following notes to the income statement:

| | |
|---|---------------------|
| 1) | \$ |
| Interest income derived from US\$ fixed deposits placed with the Head Office of Hang Seng Bank, Hong Kong. The deposit has been used to secure a bank loan borrowed by DBC's overseas subsidiary. | 300,000 |
| Gain on revaluation of staff quarters* | 20,000,000 |
| Gain on year-end revaluation of trading securities | <u>900,000</u> |
| Total per accounts | <u>\$21,200,000</u> |

All apartments were acquired during 2014 and have been used as staff quarters since acquisition. DBC changed its intention in holding the properties from a long-term investment to trading stock. The gain was the excess of the market value over the cost on acquisition at the date of the change of intention.

- 2) During 2009, DBC purchase a proprietary interest in a registered product design for use by its suppliers, to manufacture products at a price of \$1 million. During the 2016/2017 financial year, DBC sold the proprietary interest of the product design at a price of \$1.3 million, making a profit of \$300,000. DBC purchased a registered trademark in 2016/2017 for \$2 million, which was not yet reflected in the income statement. The trademark has a protection period of 10 years, starting from 2016/2017.
- 3) The product research expense charged in the income statement included \$2 million for decoration of a product research centre.

| | |
|---|------------------|
| 4) | \$ |
| Bank charges on ordinary trading transactions | 20,000 |
| Interest on bank loan* | <u>140,000</u> |
| Total per accounts | <u>\$160,000</u> |

*A bank loan of \$4 million was drawn on 1 January 2016 and was used to buy trading stock. The loan was secured with a \$2 million deposit placed by DBC's sole shareholder, Mr Wong, with a bank in Hong Kong. The loan was also secured by shares in DBC worth \$2,000,000. Mr Wong derived interest income of \$50,000 from the deposit. Apart from investing in DBC, Mr Wong did not carry on any business in Hong Kong.

- 5) The income statement recorded repairs expense of \$100,000, for acquisition of new cooking equipment replacing old ones in DBC's staff canteen.

| | |
|---|-----------------|
| 6) | \$ |
| Write off of a loan to a Hong Kong customer (5% interest and 95% principal) | 20,000 |
| Bad debts recovered (trade debts written off in the year 2015/16) | (8,000) |
| Provision (5%) on total trade debtors' balance | 10,000 |
| Provision on specified trade debtors | <u>53,000</u> |
| Total per accounts | <u>\$75,000</u> |

You are required to discuss the Hong Kong profits tax treatment of the transactions and computation presented. (15)

6. Mr Park is tax resident in South Korea, and holds the position of Chief Marketing Officer at Silver Star Corporation (SSC), a Korean company. According to his employment contract, Mr Park will be responsible for overseeing the marketing operations of SSC and its subsidiaries in various countries and jurisdictions across Asia. Though Mr Park spends more time at Hong Kong than in any other jurisdiction, he has no place of work and is required to travel to the various locations in which SSC's subsidiaries are situated. His wife and son live in Korea.

Mr Park's salary costs are shared between SSC and its subsidiaries, including the Hong Kong subsidiary, Gold Star Corporation (GSC), under a cost sharing arrangement.

Mr Park has approached you for advice, and has provided his travelling schedule as follows:

| | | |
|--|-----------|--|
| 15 May 2016 | Hong Kong | Arrival in Hong Kong and starting work at GSC's office |
| 5-27 June 2016* | Taiwan | Working at Taiwan subsidiary's office |
| 1-30 August 2016* | Singapore | Arranging and overseeing an exhibition in Singapore |
| 1-18 November 2016* | Vietnam | Working at Vietnam subsidiary's office |
| 30 December 2016 – 23 January 2017* | Thailand | Working at Thailand subsidiary's office, including 10 days' vacation leave |

*the first day being the departure day and the last day being the return day.

You are required to advise Mr Park on his Hong Kong salaries tax position, in relation to his employment with SSC for the year of assessment 2016/2017.

Please note that the Double Taxation Arrangement (DTA) between Hong Kong and South Korea is effective from the year of assessment 2017/2018. Hence, there is no protection by any DTA for the year of assessment 2016/2017. (15)

7. Branden, Inc. (BI) is a company incorporated in the United States, and has recently set up a number of subsidiary companies in various Asia-Pacific locations including Hong Kong. The Hong Kong subsidiary, Fury Ltd (FL), carries out trading of organic foods in Hong Kong. It has come to the attention of BI's management that a new tax incentive for corporate treasury centres was enacted in Hong Kong in 2016. BI's management is evaluating three possible options, in order to enjoy the benefit of the new tax incentive.

The three options are as follows:

- 1) FL to take up the function as the BI group's treasury house in addition to its existing business.
- 2) BI to set up a branch in Hong Kong to take up the group's treasury function.
- 3) A new company is to be set up in Hong Kong to take up the group's treasury function.

You are required to discuss the tax benefit which is available to a treasury centre in Hong Kong, including the requirements for entitlement to the benefit, and evaluate whether the BI group will be able to obtain the benefit under each of the three options proposed.

(15)

Appendix

Agreement between Mainland China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation (Extracts)

Article 5

Permanent Establishment

1. In this Arrangement, the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
2. The term “permanent establishment” includes especially:
 - (1) a place of management;
 - (2) a branch;
 - (3) an office;
 - (4) a factory;
 - (5) a workshop;
 - (6) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.
3. The term “permanent establishment” also encompasses:
 - (1) a building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than 6 months;
 - (2) the furnishing of services, including consultancy services, by an enterprise of One Side in the Other Side, directly or through employees or other personnel engaged by the enterprise, but only if such activities continue (for the same or a connected project) for a period or periods aggregating more than 183 days within any 12-month period.
4. Notwithstanding the preceding provisions of this Article, the term “permanent establishment” shall be deemed not to include:
 - (1) facilities used solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
 - (2) a stock of goods or merchandise belonging to the enterprise kept solely for the purpose of storage, display or delivery;
 - (3) a stock of goods or merchandise belonging to the enterprise kept solely for the purpose of processing by another enterprise;
 - (4) a fixed place of business established solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise;
 - (5) a fixed place of business established solely for the purpose of carrying on any other activity of a preparatory or auxiliary character for the enterprise;
 - (6) a fixed place of business established solely for any combination of the activities mentioned in subparagraphs (1) to (5) of this paragraph, provided that the overall activity of the fixed place of business resulting from this combination is of a

preparatory or auxiliary character.

5. Notwithstanding the provisions of paragraphs 1 and 2 of this Article, where a person, other than an agent of an independent status to whom paragraph 6 applies, is acting in One Side on behalf of an enterprise of the Other Side, and the person has, and habitually exercises, an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that One Side in respect of any activities which that person undertakes for that enterprise, unless the activities of such person exercised through a fixed place of business are limited to those provided for in paragraph 4 and under the provision of that paragraph such fixed place of business shall not be deemed to be a permanent establishment.
6. An enterprise of One Side shall not be deemed to have a permanent establishment in the Other Side only because it carries on business in that Other Side through a broker, general commission agent or any other agent of an independent status who are acting in the ordinary course of their business. However, when the activities of such an agent are wholly or almost wholly performed on behalf of that enterprise, he shall not be deemed to be an agent of an independent status within the meaning of this paragraph.
7. The fact that a company which is a resident of One Side controls or is controlled by a company which is a resident of the Other Side, or which carries on business in that Other Side (whether through a permanent establishment or otherwise), shall not of itself constitute any company of any One Side a permanent establishment of a company of the Other Side.

Article 7

Taxation of Business Profits

1. The profits of an enterprise of One Side shall be taxable only in that Side unless the enterprise carries on business in the Other Side through a permanent establishment situated therein. If the enterprise carries on business in the Other Side through a permanent establishment situated therein, its profits may be taxed in the Other Side, but only so much of them as is attributable to that permanent establishment.
2. Subject to the provisions of paragraph 3 of this Article, where an enterprise of One Side carries on business in the Other Side through a permanent establishment situated therein, there shall in each Side be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.
3. In determining the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the business of the permanent establishment including executive and general administrative expenses so incurred, whether in the Side in which the permanent establishment is situated or elsewhere. However, no such deduction shall be allowed in respect of amounts (other than reimbursement of actual expenses) paid by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, remuneration, fees or any other similar payments in return for the use of patents or other rights, or by way of commission for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the permanent establishment. Likewise, no account shall be taken, in determining the profits of a permanent establishment, for amounts (other than reimbursement of actual expenses) charged by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, remuneration, fees or any other similar payments in return for the use of patents or other rights, or by way of commission for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the head office of the enterprise or any of its other offices.
4. Insofar as it has been customary in One Side to determine the profits to be attributed to a

permanent establishment by apportioning the total profits of the enterprise to its various units or by any other methods provided for in the laws, nothing in paragraph 2 shall preclude that Side from determining the profits to be taxed by such method. However, the result of adopting such method shall be in accordance with the principles contained in this Article.

5. No profits shall be attributed to a permanent establishment by reason only of the purchase by that permanent establishment of goods or merchandise for the enterprise.
6. For the purposes of the preceding paragraphs, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason for a deviation.
7. Where profits include items of income which are dealt with separately in other Articles of this Arrangement, then the provisions of those Articles shall not be affected by the provisions of this Article.

Article 10 **Dividends**

1. Dividends paid by a company which is a resident of One Side to a resident of the Other Side, may be taxed in that Other Side.
2. However, such dividends may also be taxed in the Side of which the company paying the dividends is a resident, and according to the laws of that Side, but if the beneficial owner of the dividends is a resident of the Other Side, the tax so charged shall not exceed:
 - (1) where the beneficial owner is a company directly owning at least 25% of the capital of the company which pays the dividends, 5% of the gross amount of the dividends;
 - (2) in any other case, 10% of the gross amount of the dividends.

The competent authorities of both Sides shall by mutual agreement settle the mode of application of these limitations.

This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

Article 12 **Royalties**

1. Royalties arising in One Side and paid to a resident of the Other Side may be taxed in that Other Side.
2. However, such royalties may also be taxed in the Side in which they arise and according to the laws of that Side, but if the beneficial owner of the royalties is a resident of the Other Side the tax so charged shall not exceed 7% of the gross amount of the royalties. The competent authorities of both Sides shall by mutual agreement settle the mode of application of this limitation.

Article 13 **Capital Gains**

1. Gains derived by a resident of One Side from the alienation of immovable property referred to in Article 6 and situated in the Other Side may be taxed in that Other Side.
2. Gains derived from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of One Side has in the Other Side, including such gains from the alienation of such a permanent establishment (alone or with the whole enterprise), may be taxed in that Other Side.

3. Gains derived by an enterprise of One Side from the alienation of ships or aircraft or land transport vehicles operated in shipping, air and land transport or movable property pertaining to the operation of such ships, aircraft or land transport vehicles, shall be taxable only in that Side.
4. Gains derived from the alienation of shares in a company the assets of which are comprised, directly or indirectly, mainly of immovable property situated in One Side may be taxed in that Side. (which refers to a company the assets of which comprise not less than 50% immovable property situated in One Side, shall be implemented in accordance with the following provision:

Not less than 50% of the assets of the company must consist of immovable property at any time within the 3 years before the alienation of the shares of the company by the holder of the shares.)
5. Gains derived by a resident of One Side from the alienation of shares, other than the shares referred to in paragraph 4, or other rights in the capital of a company which is a resident of the Other Side may be taxed in that Other Side if, at any time within the 12 months before the alienation, the recipient of the gains had a participation, directly or indirectly, of not less than 25% of the capital of the company.”.
6. Gains derived from the alienation of any property, other than that referred to in paragraphs 1 to 5, shall be taxable only in the Side of which the alienator is a resident.

Article 14
Income from Employment

1. Subject to the provisions of Articles 15, 17, 18, 19 and 20, salaries, wages and other similar remuneration derived by a resident of One Side in respect of an employment shall be taxable only in that Side unless the employment is exercised in the Other Side. If the employment is exercised in the Other Side, such remuneration as is derived therefrom may be taxed in that Other Side.
2. Notwithstanding the provisions of paragraph 1 of this Article, remuneration derived by a resident of One Side in respect of an employment exercised in the Other Side shall be taxable only in that One Side if all the following 3 conditions are satisfied:
 - (1) the recipient is present in the Other Side for a period or periods not exceeding in the aggregate 183 days in any 12-month period commencing or ending in the taxable period concerned;
 - (2) the remuneration is paid by, or on behalf of, an employer who is not a resident of the Other Side;
 - (3) the remuneration is not borne by a permanent establishment which the employer has in the Other Side.