THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2015

PAPER 2.04 – HONG KONG OPTION

ADVANCED INTERNATIONAL TAXATION (JURISDICTION)

TIME ALLOWED – 3¼ HOURS

- You should answer **FOUR** out of the seven questions.
- Each question carries equal marks.
- Start each answer on a new sheet of paper. 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.
- All workings should be made to the nearest month and Hong Kong Dollar unless the question requires otherwise.
- Marks are specifically allocated for presentation.
- For your information this paper includes:

  Appendix: Avoidance of Double Taxation Arrangement between Mainland China and the Hong Kong Special Administrative Region (Extracts).

Tax Rates and Allowances

Tax Rates (2014/15)

Standard rate	15%
Corporation profits tax rate	16.5%

Progressive rates:

First $40,000	2%
Next $40,000	7%
Next $40,000	12%
Remainder	17%

Personal Allowances

Basic	$120,000
Married person's	$240,000
Child (For each dependent) the 1st and 9th child	$70,000
Additional child allowance in the year of birth	$70,000
Dependent parent/grandparent (each):	
Basic (aged 60 or above)	$40,000
Additional (aged 60 or above)	$40,000
Basic (aged 55 to 59)	$20,000
Additional (aged 55 to 59)	$20,000
Dependent brother/sister (each)	$33,000
Single parent	$120,000
Disabled dependent (each)	$66,000

Concessionary Deductions

Self-education expenses (maximum)	$80,000
Home loan interest (maximum)	$100,000
Elderly residential care expenses (maximum)	$80,000
Contributions to Mandatory Provident Fund (maximum)	$17,500

Stamp Duty rates (1 April 2010 to 22 February 2013)

Head 1(1) and Head 1(1A):

Consideration (round up to nearest $1)	Rate
Up to $2,000,000	1.5%
$2,000,001 – $2,351,760	$30,000 + 20% of excess over $2,000,000
$2,351,761 – $3,000,000	1.5%
$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	6%
$6,000,001 – $6,720,000	$180,000 + 10% of excess over $6,000,000
$6,720,001 – $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%

Stamp Duty rates (effective 23 February 2013)

Head 1(1) and Head 1(1A) – Scale 1:

Consideration (round up to nearest $1)	Rate
Up to $2,000,000	1.5%
$2,000,001 – $2,176,470	$30,000 + 20% of excess over $2,000,000
$2,176,470 – $3,000,000	3%
$3,000,001 – $3,290,330	$90,000 + 20% of excess over $3,000,000
$3,290,331 – $4,000,000	4.5%
$4,000,001 – $4,428,580	$180,000 + 20% of excess over $4,000,000
$4,428,581 – $6,000,000	6%
$6,000,001 – $6,720,000	$360,000 + 20% of excess over $6,000,000
$6,720,001 – $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%

Head 1(1) and Head 1(1A) – Scale 2:

Consideration (round up to nearest $1)	Rate
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
$6,720,001 – $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%

Special Stamp Duty (SDD) (from 20 November 2010)

Head 1(1AA) and Head 1(1B):

Holding periods of properties	Rate
Not exceeding 6 months	15%
Between 6 and 12 months	10%
Between 12 and 24 months	5%

Head 1(2):

Term of lease	Rate
Not defined or uncertain	0.25% on annual or average annual rent
Not exceeding 1 year	0.25% on total rent payable over lease term
Between 1 and 3 years	0.5% on annual or average annual rent
Exceeding 3 years	1% on annual or average annual rent

Head 2(1):

Nature of document	Rate
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

1. Marathon Generation Ltd (MGL) operates a chain of supermarkets in Hong Kong. In recent years, MGL has been growing significantly, earning a substantial amount of profit. MGL now plans to list on the Hong Kong Stock Exchange.

Two restructuring exercises must be carried out before the flotation. First, as a vertical integration, MGL will acquire Wong Kee Ltd (WKL), currently a fruit supplier to MGL. WKL's management has not run the business well, and WKL has accumulated significant losses. After acquisition, MGL will transfer its fruit sourcing department to WKL, which will then raise its selling prices to MGL by 10% in order to generate a profit on its supply of products to MGL and hence utilise its accumulated tax loss. Second, a new company, Multi Sourcing Ltd (MSL), will be established in the country of Astapor. MSL will source chickens, vegetables and meats from suppliers located in mainland China. MGL currently buys products directly from these mainland Chinese suppliers. However, in future, the mainland Chinese suppliers will sell products to MSL, which will then re-sell the products to MGL. Astapor's income tax rate is 5%.

As a separate issue, having conducted extensive market research, MGL's management made a proposal to the board of directors for the acquisition of a commercial building located in Australia for the purposes of long-term investment. The directors have recently held a board meeting in Hong Kong and approved the Australian investment. To finance its existing Hong Kong operation and the newly expanded investment in Australia, MGL had raised a new loan from a bank in Hong Kong.

You are required to:

1) **Define the term 'closely connected person' with regard to s.20.** (5)

2) **Briefly explain the tax implications of MGL's two proposed pre-flotation restructuring exercises.** (12)

3) **Determine whether the rental income derived from the property in Australia will be subject to profits tax in Hong Kong, and whether there are any tax implications on MGL's funding costs in relation to the acquisition of the property in Australia.** (8)

Total (25)

2. Mr Ford, who is a resident of the United Kingdom, purchased a luxury residential complex in Hong Kong for $50 million in December 2014. Mr Ford's primary objective in purchasing this property was the realisation of a return in the form of rental income, anticipated at 5% per annum. However, Mr Ford was prepared to sell the property in the event of receiving an attractive offer. Mr Ford has asked a friend in Hong Kong, Mr Chan, to appoint property agents in order to seek both tenants and potential buyers for the properties. If the property was rented out, Mr Chan would assist Mr Ford in collecting rental and remit the income to Mr Ford's UK bank account. Mr Ford would pay 1% of the rental income to Mr Chan as a rental collection service fee. Mr Ford has renovated the complex to make it more attractive to potential tenants and buyers, incurring decoration costs of $2 million. Mr Ford financed his property investment partly via his own funds and partly via a mortgage loan from a bank in Hong Kong. Mr Ford paid mortgage loan interest of $250,000 for the period from 1 January 2015 to 31 March 2015. Mr Ford started to rent out the whole residential complex to a Hong Kong company from 1 January 2015 onwards at monthly rent of $400,000. According to the tenancy agreement, Mr Ford paid rates in total of $50,000 for the period from 1 January 2015 to 31 March 2015. The tenant was responsible to pay a property management fee of $100,000 per month. The fee was paid through Mr Ford to the property management company. On 1 Feruary 2015, Mr Chan informed Mr Ford the Inland Revenue Department had issued a notice of demand for payment of provisional property tax for the year 2014/15. The provisional property tax payable of $900,000 was due for payment on 14 March 2015.

Mr Ford is not familiar with the Hong Kong tax system and would like to seek your advice, as a tax consultant, on the tax implications regarding the complex's rental income and disposal gain, if any.

You are required to advise Mr Ford of the tax position, including:

1) **The reporting obligation of the rental income;** (8)

2) **The disposal gain derived from the Hong Kong complex; and** (9)

3) **The treatment of the provisional property tax notice (assuming that today is 10 February 2015).** (8)

Total (25)

3. Mr Chan has been seconded by Bee, Inc. (BI) to work at its Hong Kong subsidiary's office. He arrived in Hong Kong in mid-March 2014 and commenced his secondment services on 1 April 2014. BI conducted business in the United States. Mr Chan did not sign any employment contract with the Hong Kong subsidiary for his secondment services in Hong Kong. He was still covered by the employment agreement with BI throughout the relevant periods. For the year ended 31 March 2015, his time spent working and taking leave inside and outside Hong Kong is as follows:

Days working in Hong Kong	200
Days working outside Hong Kong	135
Leave days staying inside Hong Kong	20
Leave days staying outside Hong Kong	10

Mr Chan's monthly salary during the year ended 31 March 2015 was $100,000. In addition, BI paid Mr Chan $40,000 per month to reimburse rental and building management expenses incurred on his residence, of $30,000 and $5,000 per month respectively. During the year 2014/15, Mr Chan paid $20,000 to his employer's mandatory provident fund. In March 2014, he paid tuition fees of $80,000 for a master's degree course in financial planning, which commenced in May 2014. In April 2014, BI paid a sum of $30,000 to Mr Chan to reimburse his course fees. Mr Chan took a business trip to the United States in December 2014, accompanied by his wife. His employer accordingly paid a package tour fee for Mr Chan and his wife at a discounted price of $200,000. The full market price for the package tour was $240,000. Mr Chan exercised his right on a share option to purchase 1,000 shares in BI on 2 January 2015 at $100 per share. The option was granted to him by BI unconditionally in March 2013. The market value of the shares was $80 on the date of granting and $120 on the date of exercising the option. On 1 February 2015, Mr Chan sold all 1,000 shares at $130 per share.

Mr Chan's wife was employed on a part-time basis by Fay Ltd (FL), which was incorporated and conducted business in Hong Kong. She received a total salary of $50,000 and a sum in lieu of leave of $1,000 for the year 2014/15. A sum of $10,000 was deducted by Mrs Chan's employer from her salary for contribution to a mandatory provident fund. Mrs Chan runs a consultancy business, which recorded an adjusted loss of $50,000 for the year of assessment 2014/15. Mrs Chan has not elected Personal Assessment for the year 2014/15. She stayed in Hong Kong for the whole year in 2014/15, except during the period of the US trip with Mr Chan.

Mr and Mrs Chan jointly own a property in Hong Kong, which was let for $14,000 per month for the year ending 31 March 2015. They paid rates of $1,000 per quarter according to the tenancy. During the year, they incurred interest of $150,000 on the mortgage loan borrowed to finance the purchase of the property.

You are required to:

1) **Compute the salaries tax liabilities of Mr and Mrs Chan for the year of assessment 2014/15 under separate taxation.** (12)

2) **Explain the tax treatment for:**

   a) **the secondment in Hong Kong;**
   b) **the rental refund;**
   c) **payment and reimbursement of the tuition fee;**
   d) **the package tour benefit;**
   e) **the contribution to provident fund; and**
   f) **the share option benefit.** (8)

3) **Without computing the exact tax liability, advise the Chans on whether they should elect joint assessment for the year of assessment 2014/15 under s.10 of the Inland Revenue Ordinance.** (2)

Continued

3. Continuation

4) Without computing the exact tax liability, advise the Chans on whether they can elect for personal assessment, and whether there is any advantage to electing personal assessment for the year of assessment 2014/15. (3)

Total (25)

4. Maryland Ltd (ML) was incorporated in Hong Kong, and distributes medicine and health supplements to customers in Hong Kong. ML has recently established a subsidiary company, Rowland Ltd (RL), in mainland China. According to the management's plan, RL will produce Chinese medicine products and supply to ML at arm's length prices, as decided by ML. ML will sell the products in mainland China and Hong Kong. For the mainland Chinese market, RL will be appointed as ML's sole agent, and given the authority to accept orders on ML's behalf (on condition that the orders are within trading parameters decided by ML's directors). After sales orders are accepted by RL, ML will place corresponding purchase orders to RL, which will then follow-up on the production and delivery of goods. In addition to the strategic marketing decision, the financing function of ML's mainland Chinese business will also be carried out by ML from Hong Kong. ML will second its product development manager to work at RL's office. The manager will continue to report to ML's directors. RL will pay a fee at cost plus 10% mark-up to ML, in return for the services provided by the manager. The management expects RL to begin earning a profit in its second year of operation, at which point it will pay a dividend to ML.

On 1 May 2011, ML bought 10% shares in Bee Ltd (BL), which was incorporated in China and closes its accounts annually on 31 December. BL held immovable properties in mainland China. The valuations, total assets and liabilities secured by the immovable properties are as follows:

	Immovable property at book value (RMB)	Immovable property at market value (RMB)	Total assets at book value (RMB)	Total assets at market value (RMB)	Total liabilities secured by immovable properties (RMB)
2011	60 million	70 million	100 million	180 million	30 million
2012	80 million	90 million	200 million	240 million	40 million
2013	145 million	160 million	300 million	280 million	50 million
2014	160 million	250 million	350 million	400 million	60 million

ML sold all the 10% shares in BL on 23 May 2015, and made a profit of RMB 3 million.

You are required to:

1) Comment on the Hong Kong tax position of ML relating to its business in mainland China. (10)

2) State under what conditions a Hong Kong company would be subject to income tax in mainland China. Comment on ML's China income tax position relating to the proposed secondment arrangement with RL, and its dividend income from RL. (8)

3) Comment on the income tax position in mainland China relating to ML's disposal of shares in BL. (7)

Total (25)

5.

1) You have been approached by three clients, who each seek your advice regarding the Stamp Duty implications of their recent activities as described below. Each case is to be treated independently.

a) The sale of a residential property in Happy Valley, Hong Kong from the mortgagee, B Bank, to an unrelated third party, Mr A. The sale was made on 1 June 2014 by B Bank, exercising a power of sale granted in a mortgage deed. Unknown to both Mr A and B Bank, the sale price ($9 million) was less than the market value of the property ($10 million). Mr A is a Hong Kong permanent resident and did not own any other property at the time of sale.

Explain whether, and to what extent, this case is subject to Stamp Duty under the Hong Kong Stamp Duty Ordinance. You should include your calculations on Stamp Duty payable where applicable. (6)

b) Ms C purchased a residential flat in Ma On Shan, Hong Kong for $2 million, subject to an existing mortgage of $5 million. The vendor purchased the property 10 years ago. The market value of the property on the date of sale and purchase agreement (1 June 2014) was $7.5 million. The market value of the property on the date of conveyance (30 June 2014) was $8 million. Ms C is a Hong Kong permanent resident, and owned two other flats in Hong Kong when she purchased the subject property.

Explain whether, and to what extent, this case is subject to Stamp Duty under the Hong Kong Stamp Duty Ordinance. You should include your calculations on Stamp Duty payable where applicable. (6)

c) M Ltd held 100% of the issued share capital of N Ltd; N Ltd in turn held 80% of the share capital of K Ltd. The remaining 20% of the share capital of K Ltd was owned by L Ltd. M Ltd also held 95% of the issued share capital of P Ltd, which in turn held 95% of the issued share capital of L Ltd.

On 14 December 2011, K Ltd transferred its factory premises in Hong Kong to L Ltd for a consideration of $12 million. The market value of the factory on that date was $15 million.

On 1 December 2013, M Ltd sold 15% of the share capital of N Ltd to Q Ltd, a company which is unrelated to M Ltd.

Explain whether, and to what extent, this case is subject to Stamp Duty under the Hong Kong Stamp Duty Ordinance. You should include your calculations on Stamp Duty payable where applicable. (6)

2) **In the context of stamp duty administration, explain the time limit for stamping, the penalty for late stamping, and the rules governing appeals against assessment procedures.** (7)

Total (25)

6. Berry Ltd (BEL) conducts business in Hong Kong. Its provisional income statement for the year ending 31 March 2015 shows a net profit before taxation of $3 million, inter alia, after crediting the following income and charging the following expenses:

Income	Note	$
Sales through Hong Kong agents	(a)	20,000,000
Booked profits for group companies	(b)	4,000,000
Investment income	(c)	1,200,000
Profit on sale of product design	(d)	300,000
Expenditure		
Product research expense	(e)	500,000
Depreciation	(f)	300,000
Bank charges and interest	(g)	160,000
Repairs expense	(h)	100,000
Bad debts	(i)	75,000

Explanatory Notes

a) BEL purchased goods from Hong Kong suppliers and sold to overseas customers. Over 100 overseas agents solicited customers for BEL. The agents would receive orders for BEL overseas, and forward the same to BEL for final confirmation.

b) For the "booked profits", all trading terms were negotiated and concluded by the overseas group companies of BEL. Upon conclusion of the trading terms, the overseas group companies would issue invoices to BEL. BEL then issued invoices to the respective customers pursuant to the agreed terms. Goods were delivered by the group companies to the customers directly. Trade restrictions in respective countries prevented the group companies from carrying out the transactions by themselves, so BEL was utilized as a group entity to take up the transactions and record the profits.

c)

	$
Interest on fixed deposits placed with the Head Office of Hang Seng Bank, Hong Kong. The deposit has been used to secure a bank loan (see note (f) below).	300,000
Year-end revaluation of trading securities	900,000
Total per accounts	1,200,000

d) During 2009, BEL bought the proprietary interest of a registered product design for use by its suppliers to produce the products at a price of $1 million. During the year 2014/15, BEL sold the proprietary interest of the product design at a price of $1,300,000 and hence made a profit of $300,000. Also BEL bought a registered trademark during the year 2014/15 at a price of $2 million, which was not reflected in the above income statement. The trademark has a protection period of four years starting from 2013/14.

e) The product research expenses included $150,000 for new research equipment.

f) The depreciation allowance agreed by the Inland Revenue Department for the year totaled $200,000.

Continued

6. Continuation

g)

	$
Bank charges on ordinary trading transactions	20,000
Interest on bank loan* secured by a deposit with Hang Seng Bank (see note (b) above)	140,000
Total per accounts	160,000

*The bank loan was used to buy trading stock.

h) The repairs expenses of $100,000 relate to initial repairs to a second-hand packing machine, which was acquired during the year. The expenses were incurred in restoring the machine to an operable condition.

i)

		$
Write off of a staff loan (5% interest and 95% principal)		20,000
Bad debts recovered (trade debts written off in the year 2013/14)		(8,000)
Provision	- 5 % on total trade debtors' balance	10,000
	- on specified trade debtors	53,000
Total per account		75,000

You are required to:

1) Calculate the profits tax payable by BEL for the year of assessment 2014/15, ignoring provisional tax. (10)

2) Explain your profits tax computation for BEL during the year 2014/15. (15)

Total (25)

7. Pacific Ltd (PL) commenced business in Hong Kong on 1 July 2013 and closed its first set of accounts on 31 March 2014. Miss Cheung started her employment contract with PL in September 2013. However, she resigned from her position with PL in March 2014, giving just one day's notice.

PL received a notice of estimated assement dated 1 May 2015, for the year of assessment 2013/14, from the Inland Revenue Department (IRD), which showed an estimated profit of $1 million. The notice stated that the estimated assessment was issued under s.59(3) of the Inland Revenue Ordinance. According to the tax computation made by the Finance Manager of PL, the assessable profit should be $600,000.

Mr Leong, a marketing manager at PL, resigned in April 2015, giving short notice, and returned to Taiwan after his resignation. As of 1 May 2015, a commission was payable to Mr Leong totaling $40,000. Recently, the IRD issued a notice to PL requesting that the company withholds the amount owing to Mr Leong, pending payment of his outstanding salary tax liabilities.

Mr Sam was employed by PL's holding company, Ocean, Inc. (OI), which was incorporated and carried on business in the United States as Regional Auditor. In addition to his normal duties in the United States, Mr Sam was also required to work in Hong Kong as PL's consultant on its internal control system, for various periods during the two years beginning on 1 January 2013. Mr Sam was granted a stock option on 1 January 2013 with a vesting period of two years. During the years of assessment 2012/2013, 2013/2014 and 2014/2015, Mr Sam rendered services in Hong Kong for a total of 50 days, 85 days and 63 days (up to 31 December 2014) respectively. Mr Sam resigned from his position with effect from 30 April 2015, and would not return to Hong Kong. He intended to exercise the option later on when the market condition becomes more favourable.

1) **You are required to explain PL's tax filing obligations for itself and for its employees, and the potential penalties for non-compliance.** (7)

2) **What should PL do with the estimated assessment (assuming that it is now 15 May 2014)?** (4)

3) **Does PL have any obligation to comply with the IRD's request to withhold the amount owed to Mr Leong, in order to settle his current tax liability?** (7)

4) **Advise on whether or not Mr Sam is subject to Hong Kong salaries tax in respect of the stock option granted to him while he was in the United States. If so, how and when will Mr Sam be assessed?** (7)

Total (25)

Appendix

Avoidance of Double Taxation Arrangement between the Mainland of China and the Hong Kong Special Administrative Region (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 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.

   Article 4 (Second Protocol) for Article 13

   The provision in paragraph 4 of Article 13 of the Arrangement 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 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.