



VMW TAXAND

The Netherlands signs a new tax treaty with Hong Kong

Hong Kong is currently negotiating and concluding a number of tax treaties after the decision to adopt the OECD standard on exchange of information. On March 22, 2010 the Dutch Minister of Finance and the Secretary for Financial Services and the Treasury of the Hong Kong Special Administrative Region signed the first tax treaty between the Netherlands and Hong Kong. This alert primarily focuses on the withholding tax rates in the treaty.

It is expected that the new treaty will further increase mutual investments. The main benefit is that the treaty, once in force, allows investments from Hong Kong (and indirectly China) into the rest of the world in a way that profits can be repatriated to Hong Kong without withholding tax.

The important withholding tax rates are on dividends from the Netherlands to Hong Kong and on royalties from Hong Kong to the Netherlands as the Netherlands does not levy a withholding tax on interest and royalties and Hong Kong does not levy a withholding tax on dividends and interest.

It is expected that the treaty will have effect as of January 1, 2011 in the Netherlands and as of April 1, 2011 in Hong Kong.

Dividend withholding tax

A 0% withholding tax rate will apply to dividends from the Netherlands to Hong Kong provided that certain conditions are met. Currently a 15% Dutch dividend withholding tax rate applies as no treaty is currently in place. Please note that no withholding tax is due on dividends from Hong Kong to the Netherlands.

The 0% dividend withholding tax rate applies to dividends distributed by a Dutch company to a:

1. qualifying headquarter company for a multinational group resident in Hong Kong (no minimum shareholding requirement);
2. company resident in Hong Kong owning at least 10% of the share capital of the Dutch company and which shares are traded on a recognized stock exchange;
3. company resident in Hong Kong (HK Co) owning at least 10% of the shares in the Dutch company and:
 - a. the shares of HK Co are at least 50% owned by a company resident in Hong Kong, the Netherlands or an EU country which has concluded a treaty with Hong Kong with a 0% dividend withholding tax rate (currently only Belgium and Luxembourg) and;
 - b. the shares of the parent company of HK Co are traded on a recognized stock exchange;
4. banks or insurance companies and pension funds resident in Hong Kong (no minimum shareholding requirement);



5. Hong Kong government, government institutions, political subdivisions or local authorities.

No minimum holding periods apply. The competent authority of the Netherlands can also allow the 0% rate to apply if these conditions are not met. A 10% withholding tax rate applies to all other dividends.

Currently only Belgium and Luxembourg have concluded treaties with Hong Kong which allow for a 0% withholding tax rate on dividends. The conditions for applying the 0% rate in these treaties differ significantly from the conditions in the Dutch treaty. One of the advantages of the Dutch treaty is that it allows for the 0% rate on shareholdings of less than 10% under certain conditions. It will therefore be beneficial to structure investments (of less than 10%) by Hong Kong (or indirectly Chinese) investors through the Netherlands.

The current tax treaty between China and the Netherlands dates from 1987 and allows for a 10% dividend and royalty withholding tax rate. Interposing a Hong Kong entity may therefore be beneficial once the new treaty between Hong Kong and the Netherlands enters into force. The Netherlands has been renegotiating its treaty with China. No details are known at the moment.

Hong Kong also reached consensus on a new tax treaty with Japan on March 31, 2010. This new treaty allows for a 5% withholding tax on dividends from Japan to Hong Kong. Please note that interposing a Dutch intermediate holding company can eliminate this 5% dividend withholding tax, provided that the (strict) requirements of the new treaty between Japan and the Netherlands are met. The new treaty between Japan and the Netherlands is expected to enter into force as of January 1, 2011.

Royalty and interest withholding tax

The current withholding tax rate on royalties paid by a Hong Kong company to a Dutch company is effectively 4,95%. The treaty reduces this rate to 3%. The Netherlands does not levy a withholding tax on royalties. Both countries do not levy a withholding tax on interest.

Other

The treaty is based on the OECD model treaty and includes a mutual agreement procedure (including arbitration) and a corresponding transfer pricing adjustment clause.

The treaty between Hong Kong and the Netherlands is the first treaty concluded by Hong Kong with an OECD member country which includes the latest international standard on exchange of information. This was an important requirement for the Netherlands during the negotiations.

Capital gains may, generally speaking, only be taxed in the country in which the alienator is a resident, except if

1. the alienated asset qualifies as immovable property situated in the other country;
2. movable property allocated to a permanent establishment in the other country, or



3. shares of a company if more than 50% of the value is derived from immovable property situated in the other country (with exceptions applying to for example shares quoted on certain stock exchanges).

Taxand's take

The new treaty combined with the Dutch participation exemption and the extensive treaty network of the Netherlands will make it very attractive for Hong Kong (and indirectly Chinese) companies and investment funds to invest in or through the Netherlands.

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