

## Double Tax Arrangement Between Hong Kong and Vietnam

Celia Hui [January 2009]

A comprehensive double tax arrangement between Hong Kong and Vietnam ("the HK-Vietnam DTA") was signed on 16 December 2008, which is the fifth comprehensive double taxation agreement Hong Kong signed with its trading partners, coming after those with Belgium, Thailand, the Mainland of China and Luxembourg. The HK-Vietnam DTA applies with effect in Vietnam from 1 January 2009 and in Hong Kong from 1 April 2009.

Key features of the HK-Vietnam DTA are summarized as follows:

1. The HK-Vietnam DTA provides limited benefits in withholding tax rates. The following table summarizes the preferential withholding tax rates on passive income:

	Dividend	Royalty	Interest
Non-treaty rate for Vietnam	0%	10%	10%
Non-treaty rate for HK	0%	4.95 / 4.5% **	0%
Treaty rate	10% *	7 / 10% #	0 / 10% ^

### Notes

- \* There is no withholding tax on dividends paid out of taxable profits in Vietnam. The 10% treaty rate represents the maximum rate applicable to dividends received by a Hong Kong resident should a withholding tax on dividends be levied in Vietnam in the future.
- \*\* The 4.95% rate applies to corporations whereas the 4.5% rate applies to unincorporated businesses.
- # The 7% rate applies to royalties for the use, or the right to use, any patent, design or model, plan, secret formula or process. The 10% rate applies to all other cases.
- ^ The 0% rate applies to interest payments to the HKSAR Government and recognised institutions. The 10% rate applies to all other cases.

2. Foreign companies performing business in Vietnam or having contracts with Vietnamese customers without establishing a legal entity in Vietnam are now subject to "Foreign Contractor Withholding Tax" ("FCWT") at various rates depending on the business activities performed. Service fee is subject to the FCWT at 10% on the turnover (being 5% value added tax and 5% deemed business income tax). The business income tax component of such FCWT will be eliminated under the HK-Vietnam DTA provided that a Hong Kong company does not carry on business in Vietnam through a permanent establishment ("PE") in Vietnam.

3. Under article 5 of the HK-Vietnam DTA, a PE is defined to include provision of services by an enterprise if the services continue (for the same or connected project) for a period or periods aggregating more than 180 days within any 12-month period.
4. If a Hong Kong investor has a PE in Vietnam, the income attributable to that PE will be subject to business income tax in Vietnam. If the same income is subject to Hong Kong profits tax, the tax paid in Vietnam will be allowed as a credit against the Hong Kong profits tax payable in respect of that income. The tax credit allowed includes the Vietnamese tax that would have been paid but for an exemption or reduction granted as tax incentives for foreign investments by the Vietnamese government (the sparing provision). This sparing provision applies for a period of 10 years from the day the HK-Vietnam DTA comes into effect. Please note that under the territorial taxation system in Hong Kong, it is likely that the income attributable to the PE in Vietnam will not be taxable in Hong Kong.
5. The HK-Vietnam DTA does offer tax exemption in relation to capital gains derived by a Hong Kong resident from the alienation of less than 15% interest in a Vietnamese company that does not derive 50% or more of its asset value directly or indirectly from immovable property situated in Vietnam. Transfer of business interests are generally subject to business income tax of 25% on the gains or 0.1% on the sales proceeds in Vietnam, depending on the type of business interests being sold.
6. Hong Kong employees will be exempt from Vietnamese personal income tax provided that:
  - a. they do not spend more than 183 days in Vietnam in any 12-month period commencing or ending in the fiscal year concerned;
  - b. their remuneration is not paid by, or on behalf of, an employer who is a resident of Vietnam; and
  - c. the remuneration is not borne by a PE in Vietnam.
7. Similar to the other double tax arrangements that Hong Kong has entered into so far, the exchange of information article included in the HK-Vietnam DTA is the more restrictive 1995 version of the Organisation for Economic Cooperation and Development model convention.
8. The HK-Vietnam DTA also contains "Associated Enterprise" and "Mutual Arrangement Procedure" articles similar to those in Hong Kong's other double tax arrangements as well as provisions to eliminate double taxation that include relief (for a period of 10 years from the day on which the HK-Vietnam DTA comes into effect) for tax spared as a result of tax incentives granted under Vietnam's provisions for encouraging foreign investment for development purposes.

The HK-Vietnam DTA is the fifth comprehensive double tax arrangement entered into by Hong Kong. The expansion of Hong Kong's treaty network with other countries will help encouraging a greater flow of investment, technology, talents and expertise between the two places and strengthening Hong Kong's position as the preferred location for multinational corporations to set up their regional headquarters in the Asia-Pacific region. We expect that the HKSAR government will conclude more preferential taxation terms with other countries so as to promote foreign trade and investments in Hong Kong. Investors should keep an eye on the latest announcement.

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