



Inland Revenue Department

The Government of the Hong Kong Special Administrative Region
of the People's Republic of China

DEPARTMENTAL INTERPRETATION AND PRACTICE NOTES

NO. 19

**THE AGREEMENT BETWEEN
THE UNITED STATES OF AMERICA AND HONG KONG
IN RESPECT OF THE TAXATION OF SHIPPING PROFITS**

These notes are issued for the information and guidance of taxpayers and their authorised representatives. They have no binding force and do not affect a person's right of objection and appeal to the Commissioner, the Board of Review or the Courts.

Anthony AU-YEUNG
Commissioner of Inland Revenue

28 September 1989

DEPARTMENTAL INTERPRETATION AND PRACTICE NOTES

No. 19

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INTRODUCTION

On 16 August 1989 the Commissioner of Inland Revenue, on behalf of the Hong Kong Government, signed a note accepting a proposal made by the Consul General of the United States of America in Hong Kong, on behalf of the United States Government, in respect of the taxation of income derived by residents of the two territories from the international operation of ships. Pursuant to the agreement, the Double Taxation Relief (Income from Shipping Operations) (United States of America) Order 1989 was made by the Governor in Council under section 49 of the Inland Revenue Ordinance on 29 August 1989. A copy of the Order is attached as Appendix A.

THE US 1986 TAX REFORM ACT

2. The United States Tax Reform Act of 1986 changed the basis upon which non-US resident shipowners are taxed in the United States. Previously, foreign shipowners engaged in the US shipping business were subject to US tax on their US source shipping income unless their ships were registered in jurisdictions which granted US shipowners a reciprocal exemption from tax. There was no requirement that the ships be owned by a corporation located in such jurisdictions or that the shipowners be resident in those jurisdictions. Accordingly, although Hong Kong did not grant US shipowners exemption from tax, Hong Kong shipowners who registered their ships in places such as Liberia or Panama, were able to obtain exemption from US tax on the basis of reciprocity.

3. Under the amended arrangements implemented by the Tax Reform Act, the determinant of exemption is no longer the flag or place of registry but the country of residence of the shipowner or, if the owner is a corporation, its shareholders. Exemption will be granted only where the shipowner or shareholders are resident in a jurisdiction which provides reciprocal exemption to US shipowners.

4. Non-US shipowners not satisfying the residency requirements are liable to United States tax at the rate of 4% of -

- (a) 1/2 of the gross revenue derived from an inward voyage to the United States, and
- (b) 1/2 of the gross revenue derived from an outward voyage from the United States

unless their income is considered effectively connected with a US transport business.

THE ORDER

5. Section 49 of the Inland Revenue Ordinance empowers the Governor in Council to declare by Order that arrangements have been made with a territory outside of Hong Kong to afford relief from double taxation where that territory also imposes an income tax or tax of a similar character.

6. Under the agreement with the United States, which has been ratified by the Order, the Governments of the United States and Hong Kong will exempt from tax the gross income derived from the international operation of ships by individuals who are residents of the other territory and corporations which are incorporated or managed and controlled in the other territory.

7. The exemption granted to Hong Kong corporations by the United States only applies when either :

- (a) the corporation's stock is primarily and regularly traded on an established stock market in Hong Kong, the United States or another country which grants an equivalent exemption to US corporations, or
- (b) more than 50 percent of the value of the corporation's stock is owned, directly or indirectly, by individuals who are residents of Hong Kong or of a country that grants an equivalent exemption to US corporations or by a corporation organized in a country which grants an equivalent exemption to US corporations and whose stock is primarily and regularly traded on an established stock market in that country, the United States or a country that grants an equivalent exemption to US corporations.

8. The exemption provided by Hong Kong to US corporations is based upon identical criteria.

INCOME FROM THE INTERNATIONAL OPERATION OF SHIPS

9. The shipping income to which the Order applies is the gross income arising from the international operation of ships, including –

- (a) income from the rental of ships used in international transport on a full (time or voyage) or bareboat basis;
- (b) income from the rental of containers and related equipment used in international transport which is incidental to income from the international operation of ships;
- (c) income from the participation in marine transport pools which engage in the international operation of ships; and
- (d) gains from the sale, disposal or other alienation of ships by a person primarily engaged in the international operation, lease or rental of ships.

10. International aircraft operations are specifically excluded from the scope of the agreement.

IMPLEMENTATION OF THE AGREEMENT

11. The agreement has effect with respect to taxable years on or after 1 January 1987. Income to which the Order applies derived on or after 1 January 1987 will therefore be exempt. Where the effective date of the Order falls part way through a basis period, any income eligible for exemption should be computed on a pro rata time basis.

L.N. 316 of 1989

INLAND REVENUE ORDINANCE
(Chapter 112)

**DOUBLE TAXATION RELIEF (INCOME FROM SHIPPING
 OPERATIONS) (UNITED STATES OF AMERICA)
 ORDER 1989**

Made by the Governor in Council under section 49

Citation

1. This order may be cited as the Double Taxation Relief (Income from Shipping Operations) (United States of America) Order 1989.

Declaration of arrangements

2. It is declared that—
 - (a) the arrangements specified in the Schedule have been made with the Government of the United States of America with a view to affording relief from double taxation in relation to income tax and any tax of a similar character imposed by the laws of the United States of America in respect of income derived from the international operation of ships; and
 - (b) it is expedient that those arrangements should have effect in relation to tax under the Inland Revenue Ordinance (Cap. 112) notwithstanding anything in any enactment.

SCHEDULE

[para. 2]

**AGREEMENT CONSTITUTED BY EXCHANGE OF NOTES BETWEEN THE
 GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE
 GOVERNMENT OF HONG KONG FOR DOUBLE TAXATION
 RELIEF IN RESPECT OF INCOME FROM
 INTERNATIONAL OPERATION OF SHIPS**

EXCHANGE OF NOTES

No. 1

CONSUL GENERAL OF THE UNITED STATES OF AMERICA

TO

HONG KONG COMMISSIONER OF INLAND REVENUE

Consulate General of the
 United States of America
 Hong Kong

August 1, 1989

Sir:

On behalf of the Government of the United States of America, I have the honor to propose that the Government of the United States of America and the Government of Hong Kong conclude an agreement to exempt from income tax (which term for the purposes of the agreement in the case of Hong Kong refers to profits tax), on a reciprocal basis, income derived by residents of the other

from the international operation of ships (which term for the purposes of the agreement shall not include aircraft). I further have the honor to inform you that the Government of the United States of America is prepared to conclude an agreement in the following terms:

1. The Government of the United States of America, in accordance with Sections 872(b) and 883(a) of the Internal Revenue Code, agrees to exempt from tax gross income derived from the international operation of ships by individuals who are residents of Hong Kong (other than U.S. citizens) and corporations which are incorporated in Hong Kong or controlled or managed in Hong Kong (other than corporations organized in the United States).

2. In the case of a corporation, the exemption granted by the Government of the United States of America shall apply only if the corporation meets either of the following conditions:

- (a) the corporation's stock is primarily and regularly traded on an established securities market in Hong Kong, another country which grants an equivalent exemption to U.S. corporations, or the United States; or
- (b) more than 50 percent of the value of the corporation's stock is owned, directly or indirectly, by individuals who are residents of Hong Kong or of a country which grants an equivalent exemption to U.S. corporations, or by a corporation organized in a country which grants an equivalent exemption to U.S. corporations and whose stock is primarily and regularly traded on an established securities market in that country, another country which grants an equivalent exemption to U.S. corporations, or the United States.

For the purposes of sub-paragraph (b), the Government of Hong Kong shall be treated as an individual resident of Hong Kong, and stock of a corporation owned by another corporation, partnership, trust or estate shall be treated as owned proportionately by the beneficial owners.

3. For the purposes of applying the 50 percent test to a Hong Kong corporation, if the corporation is a U.S. controlled foreign corporation as defined in Section 957(a) of the United States Internal Revenue Code, the U.S. shareholders are treated as residents of Hong Kong.

4. The Government of Hong Kong agrees to exempt from tax gross income derived from the international operation of ships by U.S. residents and corporations organized in the United States (other than corporations which are subject to tax by Hong Kong on the basis of residence).

5. In the case of a corporation, the exemption granted by the Government of Hong Kong shall apply only if the corporation meets either of the following conditions:

- (a) the corporation's stock is primarily and regularly traded on an established securities market in the United States, another country which grants an equivalent exemption to Hong Kong corporations, or Hong Kong; or
- (b) more than 50 percent of the value of the corporation's stock is owned, directly or indirectly, by individuals who are residents of the United States or of another country which grants an equivalent exemption to Hong Kong's corporations, or by a corporation organized in a country which grants an equivalent exemption to Hong Kong corporations and whose stock is primarily and regularly traded on an established securities market in that country, another country which grants an equivalent exemption to Hong Kong corporations, or Hong Kong.

For the purposes of sub-paragraph (b), the Government of the United States of America shall be treated as an individual resident of the United States of America.

6. Gross income for the purposes of this agreement includes all income derived from the international operation of ships, including:

- (a) income from the rental of ships used in international transport on a full (time or voyage) or bareboat basis;
- (b) income from the rental of containers and related equipment used in international transport which is incidental to income from the international operation of ships;
- (c) income from the participation in marine transport pools which engage in international operation of ships; and
- (d) gains from the sale, disposal or other alienation of ships by a person primarily engaged in the international operation, lease or rental of ships.

7. If any difficulty or doubt as to the interpretation or application of this agreement should arise, the competent authorities of the two Governments shall seek to resolve such difficulty or doubt by mutual agreement. For this purpose, the competent authorities are:

- (a) in the United States, the Secretary of the Treasury or his authorized representative; or any person or body authorized to perform any or similar functions at present exercisable by the above-mentioned office-bearer; and
- (b) in Hong Kong, the Financial Secretary or his authorized representative; or any person or body authorized to perform any or similar functions at present exercisable by the above-mentioned office-bearer.

8. Either Government may terminate this agreement by giving written notice of termination.

If the foregoing is acceptable to the Government of Hong Kong, I have the honor to propose that this note, together with your reply in that sense, shall constitute an agreement between the Government of the United States of America and the Government of Hong Kong which shall enter into force on the date of your reply and shall have effect with respect to taxable years on or after 1 January 1987.

I avail myself of this opportunity to renew to you, Sir, the assurance of my highest consideration.

Donald M. ANDERSON

Mr. Anthony AU-YEUNG, J.P.
Commissioner of Inland Revenue
Hong Kong

No. 2

HONG KONG COMMISSIONER OF INLAND REVENUE

TO

CONSUL GENERAL OF THE UNITED STATES OF AMERICA

Commissioner of Inland Revenue
Hong Kong

16 August 1989

Sir:

On behalf of the Government of Hong Kong, I have the honour to acknowledge receipt of your note of 1 August 1989 which reads as follows:

"On behalf of the Government of the United States of America, I have the honor to propose that the Government of the United States of America and the Government of Hong Kong conclude an agreement to exempt from income tax (which term for the purposes of the agreement in the case of Hong Kong refers to profits tax), on a reciprocal basis, income derived by residents of the other from the international operation of ships (which term for the purposes of the agreement shall not include aircraft). I further have the honor to inform you that the Government of the United States of America is prepared to conclude an agreement in the following terms:

1. The Government of the United States of America, in accordance with Sections 872(b) and 883(a) of the Internal Revenue Code, agrees to exempt from tax gross income derived from the international operation of ships by individuals who are residents of Hong Kong (other than U.S. citizens) and corporations which are incorporated in Hong Kong or controlled or managed in Hong Kong (other than corporations organized in the United States).

2. In the case of a corporation, the exemption granted by the Government of the United States of America shall apply only if the corporation meets either of the following conditions:

- (a) the corporation's stock is primarily and regularly traded on an established securities market in Hong Kong, another country which grants an equivalent exemption to U.S. corporations, or the United States; or
- (b) more than 50 percent of the value of the corporation's stock is owned, directly or indirectly, by individuals who are residents of Hong Kong or of a country which grants an equivalent exemption to U.S. corporations, or by a corporation organized in a country which grants an equivalent exemption to U.S. corporations and whose stock is primarily and regularly traded on an established securities market in that country, another country which grants an equivalent exemption to U.S. corporations, or the United States.

For the purposes of sub-paragraph (b), the Government of Hong Kong shall be treated as an individual resident of Hong Kong, and stock of a corporation owned by another corporation, partnership, trust or estate shall be treated as owned proportionately by the beneficial owners.

3. For the purposes of applying the 50 percent test to a Hong Kong corporation, if the corporation is a U.S. controlled foreign corporation as defined in Section 957(a) of the United States Internal Revenue Code, the U.S. shareholders are treated as residents of Hong Kong.

4. The Government of Hong Kong agrees to exempt from tax gross income derived from the international operation of ships by U.S. residents and corporations organized in the United States (other than corporations which are subject to tax by Hong Kong on the basis of residence).

5. In the case of a corporation, the exemption granted by the Government of Hong Kong shall apply only if the corporation meets either of the following conditions:

- (a) the corporation's stock is primarily and regularly traded on an established securities market in the United States, another country which grants an equivalent exemption to Hong Kong corporations, or Hong Kong; or
- (b) more than 50 percent of the value of the corporation's stock is owned, directly or indirectly, by individuals who are residents of the United States or of another country which grants an equivalent exemption to Hong Kong's corporations, or by a corporation organized in a country which grants an equivalent exemption to Hong Kong corporations and whose stock is primarily and regularly traded on an established securities market in that country, another country which grants an equivalent exemption to Hong Kong corporations, or Hong Kong.

For the purposes of sub-paragraph (b), the Government of the United States of America shall be treated as an individual resident of the United States of America.

6. Gross income for the purposes of this agreement includes all income derived from the international operation of ships, including:

- (a) income from the rental of ships used in international transport on a full (time or voyage) or bareboat basis;
- (b) income from the rental of containers and related equipment used in international transport which is incidental to income from the international operation of ships;
- (c) income from the participation in marine transport pools which engage in international operation of ships; and
- (d) gains from the sale, disposal or other alienation of ships by a person primarily engaged in the international operation, lease or rental of ships.

7. If any difficulty or doubt as to the interpretation or application of this agreement should arise, the competent authorities of the two Governments shall seek to resolve such difficulty or doubt by mutual agreement. For this purpose, the competent authorities are:

- (a) in the United States, the Secretary of the Treasury or his authorized representative; or any person or body authorized to perform any or similar functions at present exercisable by the above-mentioned office-bearer; and
- (b) in Hong Kong, the Financial Secretary or his authorized representative; or any person or body authorized to perform any or similar functions at present exercisable by the above-mentioned office-bearer.

8. Either Government may terminate this agreement by giving written notice of termination.

If the foregoing is acceptable to the Government of Hong Kong, I have the honor to propose that this note, together with your reply in that sense, shall constitute an agreement between the Government of the United States of America and the Government of Hong Kong which shall enter into force on the date of your reply and shall have effect with respect to taxable years on or after 1 January 1987."

I have the honour to inform you that the Government of Hong Kong has been duly authorised by the sovereign Government which is responsible for its foreign affairs to accept the foregoing proposal, and that the proposal is acceptable to the Government of Hong Kong, which therefore agrees that your note and the present reply shall constitute an agreement between the Government of Hong Kong and the Government of the United States of America which shall enter into force today and shall have effect with respect to taxable years on or after 1 January 1987.

I avail myself of this opportunity to renew to you, Sir, the assurance of my highest consideration.

Anthony AU-YEUNG

Mr. Donald M. Anderson
Consul General of the
United States of America
Hong Kong

A. J. PYNE,
Clerk of Councils.

COUNCIL CHAMBER,
29 August 1989.