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# Treatment of Hong Kong and China

## Notice 97-40

This Notice sets forth the Service's position on the treatment of the Hong Kong Special Administrative Region of the People's Republic of China (Hong Kong) and The People's Republic of China (China) on and after July 1, 1997, for purposes of the application of certain bilateral agreements and the Internal Revenue Code and Income Tax Regulations, including subpart F of the Code. Under the 1984 Sino-British Joint Declaration, China and the United Kingdom agreed that China will resume the exercise of sovereignty over Hong Kong on July 1, 1997.

### I. *U.S.-China Tax Convention*

The Agreement Between the Government of the United States of America and the Government of the People's Republic of China for the Avoidance of Double Taxation and the Prevention of Tax Evasion with Respect to Taxes on Income, T.I.A.S. No. 12065, 1988-1 C.B. 414 (the "Convention"), provides that its geographical scope is limited to the areas in which the laws relating to Chinese tax (as defined in Article 2(1) of the Convention) are in force. This limitation precludes application of the Convention to Hong Kong because the relevant law governing Hong Kong as of July 1, 1997, provides that the laws relating to Chinese tax will not apply in Hong Kong on or after July 1, 1997. The Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China, Articles 106 and 108 (1990); S. Exec. Rep. No. 7, 99th Cong., 1st Sess. 14-15, 18-19 (1985).

## II. *Reciprocal Shipping Exemption*

On and after July 1, 1997, the Agreement between the Government of the United States of America and the Government of Hong Kong for the Reciprocal Exemption with Respect to Taxes on Income from the International Operation of Ships, effected by an exchange of notes, T.I.A.S. No. 11892, 1995-1 C.B. 228 (the "Shipping Agreement"), will continue to apply in accordance with its terms. The Shipping Agreement will not apply with respect to China.

## III. *Internal Revenue Code*

Hong Kong has historically been treated as a separate country for purposes of the Internal Revenue Code and Income Tax Regulations, including subpart F of the Code. Consistent with the treatment of Hong Kong and China as separate countries under the Convention and the Shipping Agreement on and after July 1, 1997, the Service will continue to treat Hong Kong and China as separate countries on and after July 1, 1997, for purposes of the Code and regulations, including subpart F. *See* United States-Hong Kong Policy Act of 1992, § 201, 22 U.S.C. § 5721 (1996) (providing that notwithstanding any change in the exercise of sovereignty over Hong Kong, the laws of the United States will continue to apply with respect to Hong Kong on and after July 1, 1997, in the same manner as before that date unless otherwise expressly provided by law or Executive Order).

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