

**(Annex)**

The exchange of letters between the Hong Kong Inland Revenue Department and the State Administration of Taxation on September 11, 2007

The Arrangement for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with respect to Taxes on Income between the Mainland and Hong Kong (including the Protocol thereto) ("the Arrangement") was formally signed on August 21, 2006. The Arrangement entered into force on December 8, 2006 after the ratification procedures were completed. The Mainland and Hong Kong have different views on the interpretation of some of the Articles upon implementation of the Arrangement. After several round of negotiations, both sides reached agreement on the necessary implementation rules and amendments on 11 September 2007. Both sides signed the exchange of letters and initialed the Second Protocol to the Arrangement for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with respect to Taxes on Income with the Mainland ("the Second Protocol") after the meeting.

The Second Protocol was formally signed by the Secretary for Financial Services and the Treasury, Professor Chan Ka-keung, and the Deputy Commissioner of the State Administration of Taxation, Mr. Wang Li, in Beijing on January 30, 2008. For details please refer to the corresponding Press Release.

The provisions under the exchange of letters would come into effect once they were formally signed, without going through any ratification procedures. The provisions are mainly connected with the implementation of the Arrangement and the Second Protocol:

1. Institutions mutually recognized by the competent authorities of both sides

According to the Arrangement, interest arising in one Side is exempt from tax in that Side if it is derived by any institutions mutually recognized by the competent authorities of both Sides. It is stated in the exchange of letters that the institutions mutually recognized by the competent authorities of both Sides are, in the case of the Mainland, China Development Bank, The Export-Import Bank of China, Agricultural Development Bank of China, National Council for Social Security Fund and China Export & Credit Insurance Corporation.

## 2. Company assets mainly comprised of immovable property

Gains derived by a Hong Kong resident from the alienation of shares in a Mainland company where not less than 50% of the assets of which are comprised of immovable property situated in One Side, within 3 years prior to the transfer, may be taxed in that Side. In determining whether the value of immovable property equals or exceeds 50% of the value of the total assets of the company, the historical cost based on the year end book value within 3 years prior to the transfer would be adopted.

## 3. Shenzhen Bay Port Hong Kong Port Area

The Hong Kong Port Area (HKPA) was a new joint immigration and customs control point at a Shenzhen Bay Port outside the boundary of Hong Kong. However, upon enactment of the "Shenzhen Bay Port Hong Kong Port Area Ordinance", the Hong Kong Special Administrative Region (HKSAR) Government can exercise jurisdiction over the HKPA according to the laws of HKSAR from the day on which the facilities commence operation. The HKPA did not exist at the time the Arrangement was entered into. Both Sides confirmed the understanding that Hong Kong tax laws will apply in the HKPA.