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Ms Amy Lee
Clerk to the Bills Committee
Inland Revenue (Amendments) (No. 3) Bill 2009
Legislative Council Building
8 Jackson Road
Central
Hong Kong

Dear Ms Lee,

Bills Committee on Inland Revenue (Amendments) (No. 3) Bill 2009

Thank you for your letter dated 20 July 2009 inviting us to make a submission on the above Bill.

The main purpose of the Bill is to amend the Inland Revenue Ordinance (IRO) to facilitate the collection and disclosure of information in respect of taxes imposed by a foreign jurisdiction with which Hong Kong has entered into a comprehensive double taxation agreement (CDTA).

In the Legislative Council Brief (the Brief) for the Bill, the administration has pointed out that under the existing laws the Inland Revenue Department (IRD) of Hong Kong has no power to collect such information. As such, Hong Kong is unable to adopt the 2004 version of the EoI article of the Organization for Economic Cooperation and Development (OECD) Model Tax Convention (the 2004 version) in its CDTAs with other jurisdictions.

Because of this legal constraint, the existing CDTAs that Hong Kong has entered into with five jurisdictions are all based on the more restrictive 1995 OECD version of the EoI. However, the current common international norm is to adopt the more expansive 2004 version, allowing tax authorities of two contracting parties to have a wider exchange of taxpayers' information for the prevention of fiscal evasion.

The administration has further pointed out that Hong Kong's inability to adopt the 2004 version has hindered Hong Kong's efforts to expand its CDTA network and resulted in Hong Kong being under some pressure from the G20 countries to adopt the same or possibly face international sanctions.

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Given these two considerations, we consider that the enactment of the Bill is in Hong Kong's interests and in principle we support the same.

The following are our comments on some of the technicalities of the Bill.

(1) Information gathering power and obligations as regards the furnishing of information concerning taxes levied by a foreign CDTA territory

The Bill essentially confers the same information gathering powers on the IRD and imposes the same obligations on taxpayers to furnish information relating to tax levied by a foreign CDTA territory as if the information related to Hong Kong tax.

We consider this approach reasonable and appropriate.

(2) Whether restriction on the types of information to be exchanged and some other safeguards on the privacy and confidentiality of information should be provided for in the Bill itself

The Bill allows information of all kinds to be exchanged to the extent that the information sought is within the terms of an EoI article of a CDTA that Hong Kong has entered into. As a result, if Hong Kong adopts the 2004 version of the EoI without any qualification, it will be obliged, on request, to provide information relating to any types of taxes, including indirect taxes such as VAT and customs duties, imposed by the other contracting party of a CDTA.

However, in the Brief for the Bill, the administration has undertaken that Hong Kong, in adopting the 2004 version of the EoI, will seek to restrict the kinds of information to be exchanged to those relating to direct income taxes only (i.e., those types of taxes similar to profits tax, salaries tax and property tax in Hong Kong).

Such restriction will be sought in individual CDTAs that Hong Kong is going to enter into with other jurisdictions, or in documents of record between the two contracting parties. However, there are views that, instead of relying on individual CDTAs or documents of record for such restriction, the same should be provided for in the Bill itself.

We are however of the view that providing the restriction in the Bill would go against the explicit terms of the 2004 version of the EoI and lead to inflexibility.

We are of the view that while many jurisdictions may now be prepared in practice to restrict the kinds of information to be exchanged under the 2004 version of the EoI to those relating to direct income taxes, this practice and the OCED norm in that regard may change in the future.

As a result, if we are to provide for the intended restriction in the Bill, we first run the risk of being accused of not complying with the extent of information exchange required of by the 2004 version of the EoI and, thus, defeat the purpose of the proposed legislation.

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Furthermore, we will also have to amend the law should the existing practice or OECD norm of allowing the restriction change in the future.

In view of the above, we do not consider it appropriate to provide for the intended restriction in the Bill itself.

However, to address the concern expressed in some quarters of the community that the administration may sign a CDTA for the sake of expediency which may not be in the best interests of Hong Kong, Clause 3 (2) of the Bill could perhaps be changed to read as follows:

> "(1A) If the Chief Executive in Council by order declares..., and that it is ~~expedient~~ **In the best interests of Hong Kong** [i.e. replaced the word "expedient" by the phrase " in the best interests of Hong Kong"] that those arrangements should have effect, those arrangements shall have effect and, in particular - ..."

As regards the other safeguards for the protection of privacy and confidentiality of information exchanged as detailed in the Brief, we presume that the same are in line with the current OCED norms and practices and are currently achievable.

However, these norms and practices may also change over time. As such, we also consider that it is not desirable to provide for these other safeguards in the Bill itself; the administration's undertaking that it will include the most prudent relevant safeguards acceptable under the 2004 version would appear to be appropriate.

We would also note that because any CDTA must be ratified through an order made by the Chief Executive in Council, and as such must be placed before the Legislative Council, a broad consensus of public support would be required before a CDTA which omitted the above restrictions and safeguards would be ratified.

(3) Whether other further safeguards for the exchange of information should be provided for by way of subsidiary legislation and practice notes or by way of the main legislation

In the Brief, the administration has also undertaken to provide for further safeguards for the exchange of information by enacting subsidiary legislation under section 49(6) of the Inland Revenue Ordinance (IRO) and by IRD issuing practice notes.

We note that these further safeguards are mostly procedural and non contentious issues. As such, and for the same reasons given in (2) above, we do not consider that these need to be provided for in the main legislation; the proposed arrangement that these further safeguards be made by way of subsidiary legislation and by way of the practice notes would appear to be appropriate.

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Should you wish us to clarify any of the above points, please feel free to contact the undersigned at 2846 9921 or Patrick Kwong at 2846 9810.

Yours sincerely,
For and on behalf of
Ernst & Young Tax Services Limited

Agnes Chan
Partner