HKFI
The Hong Kong Federation of Insurers
香港保險業聯會

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BY FAX (2121 0420) AND BY MAIL

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Clerk to Bills Committee on Inland Revenue (Amendment) (no. 3) Bill 2009
Legislative Council
Legislative Council Building
8 Jackson Road, Central
Hong Kong

Dear Sir

RE: Bills Committee on Inland Revenue (Amendment) (No. 3) Bill 2009

We are writing in response to the request for comments by the Hon Paul CHAN, Chairman of the Bills Committee on the bill to amend the Inland Revenue Ordinance (Cap. 112) ("the Bill") to enable Hong Kong to adopt the latest international standard for exchange of information (EOI) in a Comprehensive Double Taxation Agreement (CDTA). We are the Hong Kong Federation of Insurers (HKFI), providing comments from the perspective of our membership. The HKFI, a self-regulatory body of insurers, was established to advance and promote the development of the insurance business in Hong Kong. The HKFI enjoys a high degree of self-regulation and maintains frequent dialogue with the Commissioner of Insurance on legislative issues affecting the industry. The HKFI actively promotes and perfects its self-regulatory regime with an aim of improving the professionalism of and strengthening public confidence in the insurance industry.

<u>Executive Summary</u>

We are strongly in support of the proposal to adopt the more liberal approach to the EOI article, as proposed in the Bill, and believe that it will result in significant benefits to Hong Kong as well as to foreign companies carrying on business in Hong Kong. A more liberal EOI will enable Hong Kong to overcome a significant hurdle that would currently impede negotiation of a CDTA with many foreign jurisdictions. Although Hong Kong is already a very attractive jurisdiction in which to carry on business, implementation of a CDTA with additional foreign jurisdictions would enhance that position and ensure it is maintained going forward. A CDTA between Hong Kong and other foreign jurisdictions would also remove a significant constraint impeding the operations of foreign companies in Hong Kong, facilitating their ability to expand and grow in a cost effective and competitive manner. Foreign companies carrying on business in Hong Kong

註冊有限公司 Incorporated with limited liability
香港灣仔駱克道353號三湘大廈29樓
29/F Sunshine Plaza, 353 Lockhart Road, Wanchai, Hong Kong
電話 Tel: 2520 1868 傳真 Fax: 2520 1967
網址 Website: http://www.hkfi.org.hk 電郵 E-mail: hkfi@hkfi.org.hk

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provide significant economic benefits to Hong Kong which would increase as the companies grow. If this initiative is not adopted, the continued existence of foreign operations in Hong Kong will be threatened, resulting in diminishing economic benefits to the economy of Hong Kong.

Passing of the proposed Bill would also enable Hong Kong to participate in the OECD initiative on tax havens, adopted globally by developed economies, working towards elimination of inappropriate tax avoidance facilitated by the lack of effective exchange of information between tax authorities. It is noted that in November 2005, Hong Kong endorsed the principles of transparency and exchange of tax information at the OECD Global Forum on Taxation, in Melbourne, Australia. Hong Kong should carefully identify and consider the benefits derived by its economy from not implementing these principles domestically, relative to the economic benefits of legitimate business carried on in Hong Kong.

If the more liberal EOI is not adopted by Hong Kong and CDTAs are not established on that basis, the cost competitiveness and even the financial viability of some foreign companies carrying on business in Hong Kong may be threatened. For example, an initiative adopted by the Canadian government on March 19, 2007 requires that the more liberal EOI language be included in its international tax agreements, specifically Tax Information Exchange Agreements (TIEAs) and CDTAs, going forward. Absence of an acceptable EOI could result in punitive tax measures being applied to Canadian companies in Hong Kong.

To counter concerns expressed by many in prior representations to the department regarding confidentiality of information and the protection of individual privacy and rights, it should be noted that safeguards are already included in OECD standards on EOI, that should ensure requests for tax information are only made for legitimate purposes. If Hong Kong does not trust that a particular jurisdiction will follow these standards, then it is under no obligation to conclude a CDTA with that particular jurisdiction even if the more liberal EOI is adopted.

<u>Benefits to Hong Kong of Adopting a More Liberal EOI</u>

Benefits to Hong Kong from establishing a CDTA between Hong Kong and foreign jurisdictions include the following:

- A CDTA would encourage investment and the flow of capital between Hong Kong and those foreign jurisdictions resulting in significant economic benefits to Hong Kong;

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- A CDTA could result in favourable foreign tax treatment of Hong Kong sourced earnings that would enhance the cost competitiveness of business carried on in Hong Kong by foreign companies and increase the attractiveness of Hong Kong as a place to invest and carry on business going forward;

- A network of CDTAs would strengthen Hong Kong's position as the regional headquarters and financial centre of choice for multinational companies operating in Asia, particularly in the face of competition from Singapore;

- A CDTA could result in a significant reduction of withholding taxes on passive forms of income, (i.e., dividends, interest, capital gains etc.) paid from foreign jurisdictions to Hong Kong resulting in enhanced returns to Hong Kong investors;

- CDTAs will provide taxpayers of both jurisdictions access to Competent Authority and a mechanism for resolution of disputes involving double taxation which will provide greater certainty for investors; and

- Adoption of the more liberal EOI and establishment of a network of CDTAs would enhance the standing of Hong Kong within the OECD community and ensure that it is not categorized as uncooperative and exposed to defensive measures.

Consequences of Not Adopting a More Liberal EOI

If the proposed Bill allowing a more liberal approach to the EOI is not adopted by Hong Kong and CDTAs are not established on that basis, there could be negative consequences to the Hong Kong business community. Hong Kong could be categorized as an uncooperative jurisdiction, potentially subject to defensive measures on the part of OECD members.[1] To counter inappropriate tax avoidance and in accordance with OECD initiatives, a number of Hong Kong's major trading partners are considering domestic legislation that would penalize their taxpayers who invest or carry on business in jurisdictions that do not exchange tax information on the more liberal basis.

[1] It should be noted that Hong Kong's inability to adopt the more liberal EOI has caused negative perceptions on the transparency of Hong Kong's tax regime. At the London Summit held on April 2, 2009, G20 Leaders called on countries to adopt the EOI. Hong Kong was not put on any particular list but its commitment to implement the standard was pointed out in a footnote.

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Specifically, if a more liberal approach to the EOI is not adopted by Hong Kong in the near future, then foreign companies operating in Hong Kong may suffer adverse tax consequences on Hong Kong source earnings and will find that it is no longer cost competitive to carry on business in Hong Kong (e.g. Canadian companies). This will likely result in diminishing investment in Hong Kong by foreign companies, movement of regional Asian headquarters to another Asian country with which it does have a tax treaty, withdrawal of business activities and services in Hong Kong and decreasing economic benefits to Hong Kong derived from foreign companies.

It is worthwhile noting that on August 24, 2009, the Government of the Republic of Singapore and the Government of the United Kingdom of Great Britain and Northern Ireland signed a protocol amending the Agreement for the avoidance of double taxation. This agreement incorporates the new standard for the EOI. This reinforces the importance for Hong Kong that in the face of its direct competition, it needs to adopt this more liberal approach to the EOI or risk the loss of foreign investment.

OECD Safeguard Standards

Many in the Hong Kong business community have expressed concerns about the ability of other jurisdictions to access tax information under the more liberal approach to EOI. To counter these concerns, it should be noted that under OECD standards, certain safeguards are already in place that address inappropriate requests for information, confidentiality of information provided, and to protect individual privacy and rights. For example:

1. CDTA partners would have an obligation to treat taxpayer information as confidential and used only for the specified purposes.

2. Requested information must also be necessary or foreseeably relevant to the administration and enforcement of the domestic laws in question.

3. The request for information must not go beyond what a foreign jurisdiction can obtain in its domestic situation.

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In addition, we would recommend:

4. The final decision to procure and provide information requested by foreign governments should require approval from a Director or higher level government official familiar with the details of the case. This will increase accountability to Hong Kong residents and provide a safeguard against 'fishing expeditions'.

Experience has shown that tax authority information requests are not taken lightly by the requesting jurisdiction, are made infrequently and for legitimate purposes. To the extent that a potential treaty partner is thought to be less than trustworthy regarding its intentions based on previous experience, Hong Kong is not obligated to enter into a CDTA with that particular jurisdiction even with adoption of a more liberal EOI.

Conclusion

In our view the tangible and significant benefits to be derived from expanding Hong Kong's CDTA network with the more liberal EOI approach, far outweigh the questionable benefits to be derived from certain elements of the economy that engage in inappropriate tax avoidance and rely on the lack of effective exchange of information to carry on their activities. OECD safeguards should address legitimate concerns expressed by some regarding the protection of confidential information and individual privacy. Hong Kong should consider very carefully representations not to participate in the global initiative to facilitate the exchange of information between jurisdictions in view of the potential consequences, and should adopt the more liberal approach to EOI as proposed in the Bill.

Yours truly,

James Wong
Chairman

JW/lw/sw