

立法會
Legislative Council

LC Paper No. CB(1)390/10-11

Ref: CB1/SS/2/10

Paper for House Committee meeting on 12 November 2010

**Report of the Subcommittee on the Five Orders Made under Section 49(1A) of
the Inland Revenue Ordinance and Gazetted on 15 October 2010**

Purpose

This paper reports on the deliberations of the Subcommittee on the following five Orders made under section 49(1A) of the Inland Revenue Ordinance (Cap. 112) and gazetted on 15 October 2010 -

- (a) Inland Revenue (Double Taxation Relief and Prevention of Fiscal Evasion with Respect to Taxes on Income) (Republic of Hungary) Order (L.N. 124);
- (b) Inland Revenue (Double Taxation Relief and Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital) (Republic of Austria) Order (L.N. 125);
- (c) Inland Revenue (Double Taxation Relief and Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains) (United Kingdom of Great Britain and Northern Ireland) Order (L.N. 126);
- (d) Inland Revenue (Double Taxation Relief and Prevention of Fiscal Evasion with Respect to Taxes on Income) (Ireland) Order (L.N. 127);
and
- (e) Specification of Arrangements (The Mainland of China) (Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income) (Third Protocol) Order (L.N. 128).

Background

2. Double taxation refers to the imposition of comparable taxes in more than one tax jurisdiction in respect of the same taxable income. The international

community generally recognizes that double taxation hinders the exchange of goods and services, movements of capital, technology and human resources, and poses an obstacle to the development of economic relations between economies. As a business facilitation initiative, it is the Government's policy to enter into Comprehensive Agreements for Avoidance of Double Taxation (CDTAs) with Hong Kong's trading and investment partners.

3. Hong Kong adopts the territorial basis of taxation whereby only income sourced from Hong Kong is subject to tax. A local resident's income derived from sources outside Hong Kong would not be taxed in Hong Kong and hence would not be subject to double taxation. Double taxation may occur where a foreign jurisdiction taxes its own residents' income derived from Hong Kong. Although many jurisdictions do provide their residents with unilateral tax relief for the Hong Kong tax they paid on income derived therefrom, the existence of a CDTA will provide enhanced certainty and stability in respect of the elimination of double taxation. Besides, the tax relief provided under a CDTA may exceed the level provided unilaterally by a tax jurisdiction.

The five Orders

4. Under section 49(1A) of the Inland Revenue Ordinance (Cap. 112) (IRO), the Chief Executive in Council may by order declare that arrangements have been made with the government of any territory outside Hong Kong 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 that territory.

5. L.N. 124 to L.N. 127 are made by the Chief Executive in Council under section 49(1A) of the IRO to give effect to the following CDTAs respectively:

L.N. 124

- (a) the Agreement between the Government of Hong Kong Special Administrative Region of the People's Republic of China (HKSARG) and the Government of the Republic of Hungary for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income together with a protocol to the Agreement signed on 12 May 2010 (the Hungarian Agreement);

L.N. 125

- (b) the Agreement between HKSARG and the Government of the Republic of Austria for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital together with a protocol to the Agreement signed on 25 May 2010 (the Austrian Agreement);

L.N. 126

- (c) the Agreement between HKSARG and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital Gains together with a protocol to the Agreement signed on 21 June 2010 (the UK Agreement); and

L.N. 127

- (d) the Agreement between HKSARG and the Government of Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income together with a protocol to the Agreement signed on 22 June 2010 (the Irish Agreement).

6. On 21 August 2006, the Mainland of China and the Hong Kong Special Administrative Region (the Parties) entered into an arrangement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income (the Arrangement) together with a protocol to the Arrangement (the First Protocol). By the Specification of Arrangements (The Mainland of China) (Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income) Order (Cap. 112 sub. leg. AY) made in October 2006, the arrangements in Articles 1 to 27 of the Arrangement and Paragraphs 1 to 3 of the First Protocol are specified as double taxation relief arrangements under section 49 of the IRO.

7. Subsequent to the making of the Arrangement, the Parties signed a further protocol to the Arrangement (the Second Protocol) in Beijing on 30 January 2008 to clarify some post-implementation issues of the Arrangement in order to provide greater certainty in the interpretation of certain provisions of the Arrangement.

8. On 27 May 2010, the Parties signed another protocol to the Arrangement (the Third Protocol) to replace the Exchange of Information (EoI) Article in the Arrangement with the EoI Article in the Organization for Economic Cooperation and Development (OECD) model text which was adopted in 2004 (“the 2004 version of the EoI article in the OECD model text”). L.N. 128 specifies the arrangements in Articles 1 and 2 of the Third Protocol as double taxation relief arrangements under section 49(1A) of IRO and declares that it is expedient that those arrangements should have effect.

9. The five Orders will come into operation on 9 December 2010.

The Subcommittee

10. At the House Committee meeting held on 22 October 2010, Members agreed to form a subcommittee to study the five Orders. Hon James TO was elected chairman of the Subcommittee, and the membership list of the Subcommittee is in the

Appendix. The Subcommittee held one meeting on 2 November 2010 to meet with the Administration and scrutinize the five Orders.

Deliberations of the Subcommittee

11. In examining the five Orders, the Subcommittee has focused on whether and how Hong Kong residents and enterprises will benefit from the relevant agreements, and whether there are sufficient safeguards in the agreements to protect the privacy and confidentiality of local taxpayers' information.

Progress of the work on CDTA negotiations

12. The Subcommittee notes that since the Inland Revenue (Amendment) Ordinance 2010 came into operation in March 2010¹, the Government has signed 10 CDTAs and upgraded one existing CDTA based on the 2004 version of the EoI Article of the OECD model text. The Administration gazetted three Orders (L.N. 89 to 91 of 2010) on 2 July 2010 to give effect to the three CDTAs signed with respectively Brunei, the Netherlands and Indonesia. The Legislative Council (LegCo) passed a resolution moved by the Administration to make a textual amendment to the Order on the CDTA signed with Brunei (L.N. 89) at the Council meeting on 20 October 2010. These three Orders will come into operation on 18 November 2010.²

Scope of taxes covered by CDTAs

13. The Subcommittee has sought information on the scope of taxes covered by CDTAs. The Administration has advised that the taxes covered by CDTAs are "income taxes" and "capital taxes" (as appropriate) in the broad sense. In each CDTA, there is an Article on "Taxes Covered" and the provisions therein specify the types of taxes to which the Agreement shall apply. The tax types in all the four CDTAs under scrutiny are invariably profits tax, salaries tax and property tax in the case of Hong Kong, while the tax types in the case of the other Contracting Parties of the CDTAs vary, as the tax systems of the Contracting Parties are not the same.

EoI Article under the CDTAs

14. The Subcommittee notes that during the deliberations of the Bills Committee on the Inland Revenue (Amendment) (No.3) Bill 2009, members were mainly concerned about the adequacy of safeguards to protect taxpayers' right to privacy and

¹ The Inland Revenue (Amendment) Ordinance 2010 was enacted on 6 January 2010 to empower the Inland Revenue Department (IRD) to collect and transfer information that relates to a person to a competent authority under a CDTA having effect under the new section 49(1A) of the Inland Revenue Ordinance (Cap. 112), even if IRD has no domestic tax interest in such information. The Amendment Ordinance enables Hong Kong to adopt the latest international standard for exchange of tax information in CDTAs, i.e. the 2004 version of the EoI article of the OECD model text.

² The Subcommittee formed under the House Committee to scrutinize the three Orders reported its deliberations to the House Committee on 8 October 2010. In response to Subcommittee members' views, the Administration moved a resolution to make a textual amendment to L.N. 89 at the Council meeting on 20 October 2010.

confidentiality of the tax information exchanged under CDTAs. To address the Bills Committee's concerns, the Administration presented a sample EoI Article to the Bills Committee and undertook to set out clearly all the safeguards adopted in individual CDTAs and any deviation from the sample text in its submissions to LegCo on subsidiary legislation to implement CDTAs. Besides, the Administration undertook to put in place domestic safeguards through a set of rules to be made under section 49(6) of the IRO³, and through procedural guidelines for the Inland Revenue Department (IRD) for its processing of EoI requests.

15. According to the Administration, the Hungarian Agreement, the Austrian Agreement, the UK Agreement, the Irish Agreement and the Third Protocol signed with Mainland China have adopted all the safeguards in the sample EoI Article.

Austrian Agreement

16. The Subcommittee notes that according to sub-paragraph 1 of Paragraph III of the Protocol to the Austrian Agreement, the competent authority of the applicant Party shall provide, in particular, six specified items of information⁴ to the competent authority of the requested Party when making a request for information under the Agreement to demonstrate the foreseeable relevance of the information to the request. The Subcommittee has examined the effect of this provision in the Protocol on the safeguards for taxpayers' privacy protection provided in the EoI Article of the Austrian Agreement and the safeguards provided in the Inland Revenue (Disclosure of Information) Rules (Cap. 112 sub. leg. BI) (the Rules).

17. The Administration has advised that in some CDTAs, the Contracting Parties may prefer to set out in greater detail the agreed arrangements in the form of a Protocol to the Agreement. In the negotiation process, the Administration will exercise vigilance to ensure that the provisions in the Protocol will not give rise to any effect of undermining, limiting or expanding the agreed arrangements in the main text of the Agreement.

18. Regarding sub-paragraph 1 of Paragraph III of the Protocol to the Austrian Agreement, the Administration has affirmed that the provisions therein are consistent with the Rules, according to which an EoI request should contain the particulars (i.e. the 12 information items) set out in the Schedule to the Rules. Sub-paragraph 1 of Paragraph III of the Protocol, given the way it is constructed, will not have the effect

³ At the Council meeting on 3 March 2010, LegCo approved the Inland Revenue (Disclosure of Information) Rules by way of a resolution made under section 49(6) of the Inland Revenue Ordinance (Cap. 112).

⁴ The six specified information items are -

- (a) the identity of the person under examination or investigation;
- (b) a statement of the information sought including its nature and the form in which the applicant Party wishes to receive the information from the requested Party;
- (c) the tax purpose for which the information is sought;
- (d) grounds for believing that the information requested is held in the requested Party or is in the possession or control of a person within the jurisdiction of the requested Party;
- (e) the name and address of any person believed to be in possession of the requested information;
- (f) a statement that the applicant Party has pursued all means available in its own territory to obtain the information, except those that would give rise to disproportionate difficulties.

of restricting the scope of information that may be sought by the competent authority of the requested Party from the competent authority of the applicant Party to the information set out in that Paragraph. Besides, Paragraph 3(a) of Article 25 of the Austrian Agreement provides that in no case shall the provisions of Paragraphs 1 and 2 of the same Article be construed so as to impose on a Contracting Party the obligation to carry out administrative measures at variance with the laws and administration practice of that or of the other Contracting Party. Accordingly, any EoI obligation on HKSARG arising from the Article shall not be at variance with the Rules, which are subsidiary legislation. The Administration has further advised that, in accordance with its usual practice for all CDTA negotiations, it has provided a copy of the Rules to the Austrian side, and their acknowledgement of the Rules has been recorded in the agreed minutes of the relevant negotiation meeting.

UK Agreement

19. With regard to the UK Agreement, the Subcommittee notes that the provision in the EoI Article of the Agreement regarding the parties to which the tax information exchanged may be disclosed⁵ is the same as the relevant provision in the sample EoI Article. However, in Paragraph 4 of the Protocol to the Agreement, it is provided that the UK competent authority may disclose information to the Information Commissioner, the Adjudicator and the Parliamentary Ombudsman and their staff in the investigation of complaints against the administrative actions of Her Majesty's Revenue and Customs (HMRC). The Subcommittee has sought explanation on the rationale for permitting the disclosure of information to the authorities mentioned in that Paragraph.

20. The Administration has explained that during the negotiations, the UK side explained that the Information Commissioner, the Adjudicator and the Parliamentary Ombudsman would need to examine the tax information relating to the relevant taxpayer in the course of their investigation of any complaint against the HMRC. The Administration considered the UK side's request justifiable and therefore accepted it. The Administration has advised that, according to the UK side, investigation by any of the three authorities against the HMRC will be initiated by the taxpayers concerned. The disclosure of tax information exchanged under EoI requests to these authorities is either statutorily allowed or based on the consent of the relevant taxpayers.

21. In this connection, the Administration has further explained that the Privacy Commissioner for Personal Data and the Ombudsman in Hong Kong, whose functions are similar to the Information Commissioner, Adjudicator and Parliamentary Ombudsman in UK respectively, also have the power to access the tax information

⁵ According to Paragraph 2 of Article 24 of the UK Agreement, any information received under paragraph 1 by a Contracting Party shall be treated as secret in the same manner as information obtained under the domestic laws of that Party and shall be disclosed only to persons or authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to the taxes referred to in paragraph 1.

exchanged under EoI requests if such information is required for their investigation of any complaint against the IRD.

Income from employment

22. The Subcommittee notes that under all the four CDTAs under scrutiny, the income received by a resident of a Contracting Party, which is not paid by (or on behalf of) and borne by an entity of the other Contracting Party, from employment exercised in the second-mentioned Party shall be taxable only in the first-mentioned Party if his aggregate stay in the second-mentioned Party in any relevant 12-month period does not exceed 183 days. The Administration has advised that this arrangement for allocation of taxing right mirrors the relevant provision in the OECD model text for CDTAs.

Profits from operation of international transport

23. The Subcommittee notes that under all the four CDTAs under scrutiny, the resident jurisdiction shall have exclusive taxing right in respect of profits of enterprises from the operation of ships or aircraft in international traffic. In this connection, the Administration has advised that according to the OECD model text for CDTAs, the main consideration for allocation of taxing right for such profits is the place of effective management. HKSARG will seek to secure exclusive taxing right in respect of profits of Hong Kong enterprises from operation of shipping and air transport services, as this arrangement in general is more beneficial to the relevant Hong Kong enterprises. For the four CDTAs under scrutiny, HKSARG has been successful in securing this preferred arrangement.

Royalties

24. The Subcommittee notes that currently, the effective withholding tax rate on royalties in Hong Kong is 4.95%. Under the four CDTAs, the Contracting Parties have shared taxing rights on royalties. The royalties withholding tax is capped at 3% under the Austrian Agreement, the UK Agreement and the Irish Agreement, and at 5% under the Hungarian Agreement. The Subcommittee has sought information on the amount of government revenue foregone due to the royalties withholding tax cap at 3% under the Austrian Agreement, the UK Agreement and the Irish Agreement.

25. The Administration has advised that it cannot provide an estimate in this regard since under the IRO, royalties are taxable so long as they are sourced from Hong Kong and IRD does not differentiate between the taxpayers concerned based on their resident status in maintaining relevant tax records.

Recommendation

26. The Subcommittee supports the five Orders. The Subcommittee and the Administration have not proposed any amendment to any of the Orders.

Advice sought

27. Members are requested to note the deliberations and recommendation of the Subcommittee.

Council Business Division 1
Legislative Council Secretariat
10 November 2010

**Subcommittee on the Five Orders Made under Section 49(1A) of the
Inland Revenue Ordinance and Gazetted on 15 October 2010**

Membership list

Chairman Hon James TO Kun-sun

Members Hon Albert HO Chun-yan
 Hon Paul CHAN Mo-po, MH, JP

(Total: 3 Members)

Clerk Ms Anita SIT

Legal Adviser Mr Timothy TSO