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Bills Committee on Inland Revenue (Amendment) Bill 2013
The Legislative Council Complex
1 Legislative Council Road
Central
Hong Kong

Dear Sir

INLAND REVENUE (AMENDMENT) BILL 2013

We are grateful for the opportunity to provide written views with respect to the above-mentioned Bill.

HKAB supports the Bill and urges that it be enacted as soon as possible to enable Hong Kong to abide by the new OECD norms and maintain its competitiveness.

1. Background

To put this Bill into its global perspective, this is part of a wider initiative that was commenced by the OECD in 1998 when it issued its first report on harmful tax competition.¹ This was an attempt to force so-called tax haven to undertake to comply with specified minimum levels of behaviours designed to counter tax evasion. Generally, these initiatives have been successful. All of the initially identified tax havens have since agreed to cooperate and apply OECD prescribed standards of information gathering (concerning beneficial ownership of entities formed in their jurisdictions) and exchange of information. Those that initially resisted were "named and shamed" and threatened with sanctions, and eventually they too complied.

The OECD, in a subsequent report in 2000,² overtly stated that, should a country refuse to meet these standards, OECD members would contemplate imposing sanctions against them. In practice, these sanctions have not been actually applied, largely because the identified countries agreed to comply with the

¹ "Harmful Tax Competition: An Emerging Global Issue", OECD, 1998

² "Towards Global Tax Co-Operation: Progress in Identifying and Eliminating Harmful Tax Practices", OECD, 2000

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required standards. To give the Bills Committee a sense of the possible sanctions faced by an uncooperative jurisdiction, the original list of proposed sanctions is set out below:

- To disallow deductions, exemptions, credits, or other allowances related to transactions with uncooperative tax havens or to transactions taking advantage of their harmful tax practices.
- To require comprehensive information reporting rules for transactions involving uncooperative tax havens or taking advantage of their harmful tax practices, supported by substantial penalties for inaccurate reporting or non-reporting of such transactions.
- To apply controlled foreign corporation or equivalent rules to entities established in uncooperative tax havens, to consider adopting such rules, and for countries that have such rules, to ensure that they apply in a fashion consistent with the desirability of curbing harmful tax practices.
- To deny any exceptions (eg, reasonable cause) that may otherwise apply to the application of regular penalties in the case of transactions involving entities organised in uncooperative tax havens or taking advantage of their harmful tax practices.
- To deny the availability of foreign tax credits or participation exemptions with regard to distributions that are sourced from uncooperative tax havens or to transactions taking advantage of their harmful tax practices.
- To impose withholding taxes on certain payments to residents of uncooperative tax havens.
- To enhance audit and enforcement activities with respect to uncooperative tax havens and transactions taking advantage of their harmful tax practices.
- To ensure that any existing and new domestic defensive measures against harmful tax practices are also applicable to transactions with uncooperative tax havens and to transactions taking advantage of their harmful tax practices.
- Not to enter into any comprehensive income tax conventions with uncooperative tax havens, and to consider terminating any such existing conventions unless certain conditions are met.
- To deny deductions and cost recovery, to the extent otherwise allowable, for fees and expenses incurred in establishing or acquiring entities incorporated in uncooperative tax havens.
- To impose “transactional” charges or levies on certain transactions involving uncooperative tax havens.



To its credit, the Hong Kong Government has been making changes to Hong Kong's laws to meet OECD standards. Anti-money laundering laws are a good example of this. However, as a member of the Global Forum on Transparency and Exchange of Information for Tax Purposes³ ("Global Forum") under the auspices of OECD, Hong Kong has to be perceived to be willing to take further steps to pass legislation to comply with these new OECD standards which is crucial to maintaining Hong Kong's competitiveness.

2. The Need For the Bill

The Bill addresses the deficiencies in Hong Kong that were identified by the Global Forum. Principally, the Forum's Peer Review Group noted that Hong Kong's laws do not permit taxpayer information to be exchanged under stand-alone taxation information exchange agreements (TIEAs), but only pursuant to CDTAs. It therefore recommended that Hong Kong should amend its tax laws to permit it to enter into TIEAs. The OECD categorically rejects the notion that jurisdictions can undertake to exchange information only pursuant to CDTAs (as has been Hong Kong's policy to date), and insists that they be willing to enter into TIEAs as well.

At the same time, the model TIEA promulgated by the OECD represents the globally accepted template for TIEAs. It is therefore essential that Hong Kong's tax laws permit it to comply with the terms of such model agreement.

From a timing viewpoint, it is essential that the Bill be enacted before the Peer Review Group completes its Phase 2 report (in September 2013). The Phase 2 report will measure Hong Kong's actual implementation of, and compliance with, the OECD's standards relating to exchange of information.

3. Scope of the Bill

We note that the additional exchange of information powers under the Bill are limited to permitting information requests with respect to (a) years prior to entry into a CDTA or TIEA, provided that such information is foreseeably relevant to determining a person's tax liability in subsequent years, and (b) taxes other than the specific income taxes to which a comprehensive tax treaty apply. There are other changes (e.g. extending the IRD's information-gathering power to include information within a person's "control" (not merely possession)) in order to meet the exchange of information obligations in the model TIEA. Other changes are consequential (e.g. to extend the search warrant powers to obtain information under CDTAs and TIEAs).

³ "Peer Review Report of Hong Kong, China - Phase 1: Legal and Regulatory Framework", OECD, 2011



4. Concerns Raised By Panel on Financial Affairs Panel (Panel)

We understand that the Panel has expressed some reservations about the Bill. We would like to share our views thereon.

(a) Competitiveness

The Panel questioned the need and justification "for enhancing exchange of information for tax purposes which might undermine the competitiveness of Hong Kong's simple tax regime in attracting foreign direct investment".

We are concerned that, if the OECD were to impose sanctions against Hong Kong as listed above for its failure to enact the Bill, Hong Kong will be less attractive to foreign investors because of the effect of those sanctions upon them. More importantly, this will also negatively impact our Hong Kong businesses.

(b) Retroactivity

Another concern raised by the Panel was that "the proposed relaxation of the current limitation on disclosure in response to an exchange of information request might compromise the policy of no retrospectivity for exchange of information arrangements".

We believe that the Bill is not as a technical matter retroactive. Of more concern, the OECD has taken the strict position that such information must be disclosed for jurisdictions to be regarded as complying with the new exchange of information standards. Practically, as a very prominent and visible member of the global trade and investment community, Hong Kong has no choice but to comply.

(c) Effect On CDTAs

The Panel also expressed concern about "the implications of the availability of a legal framework for TIEAs on the Government's ability to negotiate comprehensive double tax agreements with its trading and investment partners".

We understand that in reality some countries do not have any interest in entering into a CDTA with Hong Kong, and instead increasingly insist on a TIEA with Hong Kong. The OECD is supporting countries that take this position.



More practically, the OECD has adamantly taken the position that jurisdictions such as Hong Kong cannot insist on entry into a CDTA as a prerequisite for exchange of information.

We note that the Hong Kong Government has undertaken to continue to prioritise CDTAs over TIEAs and to seek to persuade other countries to enter into the former rather than the latter. This is a very practical approach supported by HKAB.

(d) Confidentiality

Finally, the Panel expressed concern about "safeguards on taxpayers' privacy and confidentiality of information in these exchanges".

We note that Hong Kong has a number of safeguards in place to protect taxpayers' interests before their information is disclosed to foreign tax authorities,⁴ and these safeguards will continue to remain in place. These include the service of notice on the taxpayer prior to information about it being exchanged, and the conferral of appeal rights. The OECD's Peer Review Group did not object to these procedures. It is noteworthy that Hong Kong is one of only a small handful of jurisdictions that has sought to protect taxpayer's rights through such means.

5. Observations

More generally, HKAB supports the Bill because it is designed to ensure that taxpayers comply with their tax obligations, both in Hong Kong and in other countries. It is also in Hong Kong's interests that as an international financial centre to be seen not to be assisting or condoning tax evaders.

We have no objection to the disclosure of this submission. Should you have any questions about this submission, please contact the Secretariat (Ivy Wong at 2521-1160).

Yours faithfully

Boey Wong
Secretary

⁴ Inland Revenue (Disclosure of Information) Rules