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**Panel on Financial Affairs**

**Meeting on 4 February 2013**

**Background brief on tax information exchange arrangements**

**Purpose**

This paper provides background information on the development of Hong Kong's network of comprehensive avoidance of double taxation agreements ("CDTAs") and tax information exchange arrangements. It also summarizes the major views and concerns expressed by members of the Panel on Financial Affairs ("FA Panel") during discussion on related matters in the 2008-2009 to 2012-2013 sessions.

**Background**

2. In the 1998-1999 Budget, the then Financial Secretary announced that the Government would actively negotiate CDTAs with its major trading and economic partners, which served as a business facilitation initiative to minimize the incidence of double taxation<sup>1</sup> that would hinder cross-border trade and investment. Since then, the Administration has been expanding Hong Kong's CDTA network to enhance its position as an international business and financial centre while providing relief for double taxation. The list of jurisdictions which have entered into CDTAs with Hong Kong as at end of November 2012 is in **Appendix I**.

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<sup>1</sup> Double taxation is generally defined as the imposition of comparable taxes in two or more places on the same taxpayer in respect of the same subject matter and for identical periods. It impedes trade investment and the flow of talent among economies if no appropriate relief measure is in place.

## Article on exchange of information in CDTAs

3. A CDTA normally includes an article that provides for the exchange of information ("EoI") necessary for the carrying out of the agreement between the two contracting parties. Before 2010, the Inland Revenue Department ("IRD") could exercise its powers under the Inland Revenue Ordinance (Cap. 112) ("IRO") to collect taxpayers' information only for ascertaining their liability, responsibility and obligation under the domestic tax law. Following legislative amendments to IRO that came into effect in March 2010<sup>2</sup>, IRD is enabled to also exercise the information gathering powers and share the information obtained in response to requests for information made by Hong Kong's CDTA partners for their own tax purposes.

4. Currently, Hong Kong adopts for its CDTAs the 2004 version of the EoI Article in the Organization for Economic Cooperation and Development ("OECD") Model Tax Convention (**Appendix II**). According to the Administration, it has deployed the most prudent safeguards available to protect the confidentiality of the information exchanged on a case-specific basis in response to legitimate requests. The salient features of the current EoI arrangement are as follows–

- (a) Information will only be exchanged with the contracting party upon receipt of requests and no information will be exchanged on an automatic or spontaneous basis;
- (b) Information sought should be foreseeably relevant, i.e. no fishing expeditions;
- (c) The scope of EoI is confined to taxes covered by CDTAs;
- (d) The contracting parties must only use the information provided for purposes specified in CDTAs. Information exchanged is to be used for the assessment or collection of, the enforcement or prosecution in respect of, the determination of appeals in relation to the taxes covered by the CDTAs;

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<sup>2</sup> Prior to 2010, IRD might seek to exchange information only when there was domestic tax interest at stake. Such a provision had limited the ability of Hong Kong to conclude CDTAs with other jurisdictions, as most of them have already adopted the 2004 version of the EoI article in the Organization for Economic Cooperation and Development Model Tax Convention on Income and on Capital. Enactment of the Inland Revenue (Amendment) Ordinance 2010 in January 2010 has allowed IRD to collect and disclose a taxpayer's information in response to requests made by the treaty partners even when the information is not required for domestic tax purposes. The Report of the Bills Committee to study the Inland Revenue (Amendment) (No.3) Bill 2009 is available in the following link: <http://www.legco.gov.hk/yr08-09/english/bc/bc10/reports/bc100106cb1-755-e.pdf>.

- (e) The contracting parties will only exchange information that does not relate to any period before the relevant provisions of the relevant CDTA came into effect;
- (f) Information received by CDTA partners should be treated as confidential;
- (g) Information will only be disclosed to the tax authorities and not for release to their oversight bodies unless there are legitimate reasons given by the CDTA partners;
- (h) Information requested shall not be disclosed to a third jurisdiction; and
- (i) There is no obligation to supply information under certain circumstances, for example, where the information will disclose any trade, business, industrial, commercial or professional secret or trade process, or which will be covered by legal professional privilege etc.

### **Need for further changes to the exchange of information regime**

5. According to the Administration, although the efforts to expand Hong Kong's CDTA network since 2010 have yielded fairly satisfactory results so far, the negotiations with different jurisdictions have revealed an emerging need to re-visit the current EoI arrangements, particularly in respect of the restrictive position in the area of tax types and limitation on disclosure.

#### Tax types

6. As Hong Kong has a simple tax system under which only three direct taxes are imposed (i.e. profits tax, salaries tax and property tax), the current arrangement has sought to restrict EoI to similar direct taxes which are covered by the CDTAs only. The Administration has pointed out that some jurisdictions such as the Netherlands, the United Kingdom, France, Japan and Mexico have raised serious concerns on the issue of tax types during the negotiations of CDTAs, given that their tax systems are far more complex than that of Hong Kong, and cover a much wider range of tax types and sometimes different level of taxes. Notwithstanding that the Administration has eventually managed to conclude CDTAs with these jurisdictions, the Administration has undertaken to re-visit the issue of tax types with them in the event of any future relaxation of Hong Kong's position on the matter.

### Limitation on disclosure

7. Currently, the Administration has adopted a highly stringent approach in the EoI arrangement by not entertaining request for any information relating to a period before the provisions of the relevant CDTA have taken effect. The Administration has pointed out that this has posed practical problems and fallen short of meeting the CDTA partners' practical requirements, as information generated prior to the effective date of a CDTA may in fact be foreseeably relevant to the tax assessments after the relevant provisions of the CDTA came into effect.

### **Recent developments relating to exchange of tax information in the international arena**

#### Peer review by the Global Forum on Transparency and Exchange of Information for Tax Purposes

8. The Global Forum on Transparency and Exchange of Information for Tax Purposes ("Global Forum") formed under the auspices of the OECD, of which Hong Kong is a member, has launched a two-phase peer review<sup>3</sup> exercise to evaluate jurisdictions' compliance with the international EoI standard. In October 2011, the Global Forum endorsed the Phase 1 peer review report on Hong Kong. The review report has affirmed the efforts of Hong Kong in enhancing tax transparency and concluded that Hong Kong has adequate legal and regulatory framework to facilitate effective EoI. One of the recommendations in the review report is that Hong Kong should have in place a legal framework for entering into Tax Information Exchange Agreements ("TIEAs")<sup>4</sup> so as to make available both CDTA and TIEA as EoI instruments for the jurisdictions concerned to discuss as to whether CDTA or TIEA is more suitable. The existence of a legal framework for TIEA will have a significant bearing on whether Hong Kong is able to pass the Phase 2 peer review.

#### Updated version of EoI article approved by the Organization for Economic Cooperation and Development

9. In July 2012, the OECD approved an update to the EoI article of its Model Tax Convention and its Commentary. The 2012 version features a new requirement to allow the use of information exchanged for other purposes

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<sup>3</sup> Phase 1 of the review examined the legal and regulatory framework in each jurisdiction whereas Phase 2 evaluated the implementation of the standard in practice.

<sup>4</sup> Unlike CDTAs, TIEAs provide for EoI mechanism only without double taxation relief. The existing tax laws in Hong Kong only allow it to enter into tax agreements with other jurisdictions when there is double taxation relief.

(i.e. non-tax related) provided that such use is allowed under the laws of both contracting parties and the competent authority of the supplying party authorizes such use.

### **Consultation with relevant stakeholders**

10. The Administration conducted a two-month consultation exercise in May 2012 with some 50 business chambers and professional bodies to gauge their views as to whether Hong Kong should put in place a legal framework to enter into TIEAs with other jurisdictions. According to the Administration, most of the stakeholders that responded supported the provision of a legal framework for TIEAs so that Hong Kong could avoid being labeled as an uncooperative jurisdiction and the possibility of having sanctions unilaterally imposed on Hong Kong. Nevertheless, most of the stakeholders considered that concluding CDTA with Hong Kong's trading and investment partners should remain the future priority.

### **Legislative proposals to amend the Inland Revenue Ordinance and the Disclosure Rules**

11. The Administration intends to introduce legislative proposals to amend the IRO and the Inland Revenue (Disclosure of Information) Rules (Cap. 112 sub. Leg. BI) as appropriate, so as to put in place a legal framework for TIEA, expand the coverage of tax types and usage of tax-related information under the EoI arrangement and to allow the disclosure of information generated prior to the effective date of a CDTA which may in fact be foreseeably relevant to the tax assessments after the CDTA comes into effect.

### **Oral question at Council meeting of 12 May 2010**

12. At the Council meeting of 12 May 2010, Hon CHAN Kin-por raised a written question regarding the competitiveness of Hong Kong's taxation regime. Mr CHAN expressed concerns about the measures to enhance tax transparency in order to meet the prevailing requirements of OECD (i.e. 2004 version of the EoI Article), so as to avoid imposition of sanctions by members of the Group of Twenty on Hong Kong and maintain Hong Kong's competitiveness in international tax relations. Details of the question and the Administration's reply are hyperlinked in **Appendix III**.

## **Deliberations of the Panel on Financial Affairs**

13. The FA Panel discussed issues relating to expansion of CDTAs and the latest developments with regard to EoI arrangements at the meetings held on 4 May 2009 and 5 November 2012. Major views and concerns expressed by members are summarized in the ensuing paragraphs.

### Privacy protection

14. Some members expressed concern about protection of the confidentiality of the tax information exchanged with another jurisdiction under a CDTA, and the mechanism to ensure that only legitimate and justifiable requests could be entertained. Some members took the view that extending IRD's power to gather information from taxpayers and provide the information to the contracting parties of CDTA should be examined and taken forward in a prudent manner, taking into consideration the uniqueness of Hong Kong's small and open financial market and the possible number of requests for information from the contracting parties.

15. The Administration explained that information exchange was conducted on a case-specific basis and adequate safeguards had been put in place to protect the confidentiality of the information exchanged. IRD would carefully consider requests for tax information having regard to a set of prescribed criteria, including whether the information under request was directly related to tax purposes and within the coverage of CDTAs or the future TIEAs.

16. As to whether the taxpayer concerned would be informed of the request for information on his case, the Administration advised in the negative, pointing out that where the information was requested for investigation of alleged criminal offences, informing the taxpayer concerned might hamper the investigation process. Moreover, as the relevant information had to be provided to the other contracting party within a specified period in accordance with OECD's requirement, it would not be practicable to notify the taxpayer concerned and allow time for him to make representation in this respect.

### Expanding the exchange of tax information regime and introducing a new regime on tax information exchange arrangements

17. On the proposal to expand the coverage of tax types and usage of tax-related information under the existing EoI regime in CDTAs and introducing a legislative framework for TIEA, some Panel members expressed strong reservation in view of the great differences between the tax regime of Hong Kong and those of other jurisdictions, and the risk of jeopardizing the

attractiveness of Hong Kong as an international financial centre to foreign investment. These members considered that the Administration should not be too proactive in bringing the EoI arrangements on par with the international standard. They urged the Administration to enhance the EoI regime only where absolutely necessary to meet the minimum requirements, in particular as the Administration still managed to conclude CDTAs with jurisdictions which had raised concerns on the limitations of Hong Kong's EoI regime during negotiations, and as long as the situation did not give rise to any critical problem, such as imposition of sanctions on Hong Kong. There was also a suggestion that the Administration should take into account similar policy initiatives in the Mainland regarding the development of the EoI regime.

18. The Panel also discussed whether the availability of a TIEA regime might hamper the ongoing efforts in the negotiation of CDTAs with potential partners as it was a bilateral matter to be discussed between two jurisdictions concerns as to whether a CDTA or a TIEA was more suitable if both options were available. The Administration assured members that, given the economic benefits of CDTAs, it would remain the policy priority of the Administration in future to expand Hong Kong's network of CDTAs with its major trading and investment partners.

### **Latest development**

19. At the meeting to be held on 4 February 2013, the Administration will brief the FA Panel on the detailed legislative proposals to enhance the existing EoI arrangements to international standards and to enable Hong Kong to put into place a legal framework for entering into TIEAs with other jurisdictions where necessary.

### **Relevant papers**

20. A list of the relevant papers on the LegCo website is in **Appendix III**.

**Jurisdictions which have concluded Comprehensive Avoidance of  
Double Taxation Agreements (CDTAs) with Hong Kong  
(as at end-November 2012)**

	<b>Jurisdictions</b>	<b>Year of signature of agreement</b>
1.	Belgium*	2003
2.	Thailand*	2005
3.	Mainland China*	2006
4.	Luxembourg	2007
5.	Vietnam*	2008
6.	Austria	2010
7.	Brunei	2010
8.	France*	2010
9.	Hungary	2010
10.	Indonesia	2010
11.	Ireland	2010
12.	Japan*	2010
13.	Kuwait	2010
14.	Liechtenstein	2010
15.	Netherlands*	2010
16.	New Zealand	2010
17.	United Kingdom*	2010
18.	Czech Republic	2011
19.	Malta	2011
20.	Portugal	2011
21.	Spain	2011
22.	Switzerland*	2011
23.	Jersey	2012
24.	Malaysia*	2012
25.	Mexico	2012
26.	Canada	2012

Note: Those with an asterisk are among the top 20 trading partners of Hong Kong. For Mainland China, the "arrangements" instead of agreements were concluded due to its constitutional relationship with HKSAR.

Source: Inland Revenue Department, [http://www.ird.gov.hk/eng/tax/dta\\_inc.htm](http://www.ird.gov.hk/eng/tax/dta_inc.htm)



**EoI Article in  
the OECD Model Tax Convention on Income and on Capital  
(2004 version)**

1. The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws concerning taxes of every kind and description imposed on behalf of the Contracting States, or of their political subdivisions or local authorities, insofar as the taxation thereunder is not contrary to the Convention. The exchange of information is not restricted by Articles 1 and 2.

2. Any information received under paragraph 1 by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State 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, the determination of appeals in relation to the taxes referred to in paragraph 1, or the oversight of the above. Such persons or authorities shall use the information only for such purposes. They may disclose the information in public court proceedings or in judicial decisions.

3. In no case shall the provisions of paragraphs 1 and 2 be construed so as to impose on a Contracting State the obligation:

- a) to carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;
- b) to supply information which is not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;
- c) to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information the disclosure of which would be contrary to public policy (*ordre public*).

4. If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall use its information gathering measures to obtain the requested information, even though that other State may not need such information for its own tax purposes. The obligation contained in the preceding sentence is subject to the limitations of paragraph 3 but in no case

shall such limitations be construed to permit a Contracting State to decline to supply information solely because it has no domestic interest in such information.

5. In no case shall the provisions of paragraph 3 be construed to permit a Contracting State to decline to supply information solely because the information is held by a bank, other financial institution, nominee or person acting in an agency or a fiduciary capacity or because it relates to ownership interests in a person.

(Source: Appendix B to the Administration's paper on "Comprehensive Avoidance of Double Taxation Agreements and Exchange of Tax Information Arrangements" (LC Paper No. CB(1)91/12-13(04))

## List of relevant papers

Date	Event	Paper/Minutes of meeting
4 May 2009	Meeting of the Panel on Financial Affairs ("FA Panel")	<a href="#">Discussion paper</a> (LC Paper No. CB(1)1408/08-09(03))  <a href="#">Minutes</a> (LC Paper No. CB(1)2092/08-09)
24 June 2009	-	<a href="#">Legislative Council Brief on Inland Revenue (Amendment) (No.3) Bill 2009</a> (FIN CR 12/2041/46)
6 January 2010	Council meeting	<a href="#">Report of the Bills Committee on Inland Revenue (Amendment) (No.3) Bill 2009</a> (LC Paper No. CB(1)755/09-10)
12 May 2010	Written question raised by Hon CHAN Kin-por on "Competitiveness of Hong Kong's taxation regime" at the Council meeting	<a href="#">Hansard</a> (pages 82 to 85)
July 2012	-	<a href="#">Information paper provided by the Administration on "Comprehensive Avoidance of Double Taxation Agreements"</a> (LC Paper No. CB(1)2381/11-12(01))
5 November 2012	Meeting of the FA Panel	<a href="#">Discussion paper</a> (LC Paper No. CB(1)91/12-13(04))  <a href="#">Information note</a> (LC Paper No. IN03/12-13)  <a href="#">Minutes</a> (LC Paper No. CB(1)359/12-13)