For discussion on
5 November 2012

Legislative Council Panel on Financial Affairs

Comprehensive Avoidance of Double Taxation Agreements and Exchange of Tax Information Arrangements

Purpose

This paper briefs Members on the Administration's efforts to expand Hong Kong's network of comprehensive avoidance of double taxation agreements ("CDTAs") and on the latest developments with regard to exchange of tax information arrangements.

Objectives of Tax Treaty Policy

2. Since 1998-99, the Administration has been committed to establishing a network of CDTAs with our major trading and investment partners so as to provide certainty on taxation of cross-border activities and relief for double taxation[1], thereby facilitating flow of trade, investment and talent between Hong Kong and the rest of the world. At the same time, Hong Kong, as a responsible member of the international community, is committed to enhancing tax transparency and preventing tax evasion. We have incorporated in all the CDTAs that Hong Kong has signed an article on exchange of information ("EoI") that is on par with the prevailing international standard as far as practicable.

Expanding Hong Kong's CDTA Network

3. Before 2010, Hong Kong could not adopt the then prevailing international standard on EoI in our CDTAs because of the then legal constraint in the Inland Revenue Ordinance (Cap. 112) ("IRO") that EoI could only be conducted when there was domestic tax interest at stake. This was a major obstacle in our CDTA negotiations with other jurisdictions. In January 2010, the Legislative Council enacted relevant legislative amendments to the IRO to remove the domestic tax interest requirement for the purpose of EoI. Since the

[1] 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 manner and for identical periods. It impedes trade investment and the flow of talent among economies if no appropriate relief measure is in place.

legislative amendments came into effect in March 2010, we have by now signed 20 new CDTAs in addition to the five CDTAs which were signed before 2010. Among the top 20 trading partners of Hong Kong, we have already signed CDTAs with 10 of them and are currently at various stages of CDTA negotiations with four of the remaining ten, namely India, Italy, South Korea and United Arab Emirates. A list of jurisdictions with which we have signed CDTAs is at **Annex A**.

4. In the years ahead, we will continue our efforts to further expand our CDTA network with our traditional trading and investment partners as well as emerging economies with which we see potential for growth in bilateral trade and investment. We will also continue to consult the business community and public organizations involved in the promotion of trade and investment on a regular basis, so as to tap their views on potential CDTA partners.

Existing EoI Arrangement

5. Our existing EoI regime and related safeguards as reflected in the IRO, the Inland Revenue (Disclosure of Information) Rules (Cap. 112 sub leg BI) ("the Disclosure Rules") and the Orders implementing individual CDTAs are generally based on the 2004 version of the EoI Article in the Organisation for Economic Cooperation and Development ("OECD") Model Tax Convention on Income and on Capital (see **Annex B**), except for certain modifications to address local needs. To recapitulate, the current EoI arrangement has the following salient features -

(a) We will only exchange information 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 the CDTAs;

(d) Information exchanged is to be used only 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;

(e) We 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 our 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 would disclose any trade, business, industrial, commercial or professional secret or trade process, or which would be covered by legal professional privilege etc.

Need for Further Changes to the EoI Regime

6. Although our efforts to expand Hong Kong's CDTA network since 2010 have yielded fairly satisfactory results thus far, our negotiations with different jurisdictions revealed an emerging need to re-visit our current EoI arrangements, particularly in respect of our restrictive position in the area of tax types (paragraph 5(c) above) and limitation on disclosure (paragraph 5(e) above), in order to facilitate the conclusion of further CDTAs in the years ahead.

Tax Types

7. Hong Kong has a simple tax system, under which only three direct taxes are imposed, namely profits tax, salaries tax and property tax. From Hong Kong's own perspective, we considered that EoI for the purposes of these direct taxes would suffice and hence have sought to restrict the EoI Article to similar direct taxes which are covered by the CDTAs only. However, some of jurisdictions such as the Netherlands, the United Kingdom, France, Japan and Mexico did raise serious concerns on the issue of tax types during the negotiations. As a matter of fact, the tax systems of most jurisdictions are far more complex than that of Hong Kong and have a much wider range of tax types, e.g. value-added tax, inheritance tax, and sometimes different level of taxes, e.g. federal and state taxes. Understandably, the tax authorities of these jurisdictions would like information from CDTA partners to facilitate their investigation of tax evasion cases concerning income taxes (i.e. those taxes covered by the relevant CDTA) to also be applicable to other tax types. This is particularly so where these other tax types may also be administered by the same tax authorities. Although we have eventually managed to conclude CDTAs with these jurisdictions with the EoI Article still restricted to taxes covered by the respective CDTAs, we have undertaken to re-visit the issue of tax types with them in the

event of any future relaxation of our position in this regard.

Limitation on Disclosure

8. We have been mindful that there has been concern about taxpayers' rights and confidentiality of information exchanged with other tax authorities. In this regard, we have taken a highly stringent approach and will not entertain any request for any information relating to a period before the provisions of the relevant CDTA have taken effect. While this principle may provide maximum safeguard to taxpayers in Hong Kong, it has posed practical problems and fallen short of meeting our CDTA partners' practical requirements. 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. The current arrangement is not desirable in terms of enhancing tax transparency and combating tax evasion and we see the need for improvement.

Other Recent Developments Relating to EoI

9. There have been growing aspirations to prevent and combat fiscal evasion in the international arena. In July 2012, the OECD approved an update to the EoI Article of its Model Tax Convention and its Commentary. In gist, the 2012 version of the EoI Article features a new requirement to allow the use of information exchanged for other purposes (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. This new mandatory feature was previously an optional provision to be decided by the contracting parties. Apart from this, the 2012 version also carries major changes in the following ways –

(a) It has provided more detailed interpretation of the prevailing standard of "foreseeable relevance" and the existing term "fishing expeditions", both of which are relevant to the consideration of the competent authority of the requested party as to whether an EoI request should be entertained or not. In this context, it has considerable elaboration on how a request which relates to a group of taxpayers not individually identified should be treated; and

(b) It has provided for an optional default standard of time limits for supplying information with a view to improving the speediness and timeliness of EoI.

10. As mentioned in paragraph 5(d) above, our position so far in relation to

the usage of information exchanged is that such information should not be used for non-tax related purposes. If the information appears to be of value to the requesting party for such other purposes, e.g. to combat money laundering, the requesting party must resort to means specifically designed for that purpose, e.g. through mutual legal assistance mechanism.

11. Nonetheless, with the latest development in the international arena, we see the need to re-visit the restrictive approach for EoI under the CDTA regime, taking into account in particular the fact that our domestic legislation (i.e. the Drug Trafficking (Recovery of Proceeds) Ordinance (Cap. 405), the Organized and Serious Crimes Ordinance (Cap. 455) and the United Nations (Anti-Terrorism Measures) Ordinance (Cap. 575)) already require IRD officers to disclose confidential information to authorised officers of law enforcement agencies designated under the relevant legislation to enable them to perform their duties thereunder. It follows that we should allow our CDTA partners to use the information exchanged for other purposes when such information may be used for such other purposes under the laws of both sides and the competent authority of the supplying party authorises such use.

12. As regards requests concerning a group of taxpayers, we consider that as long as the requesting party could substantiate that its request is related to tax purposes and could demonstrate that the request could meet the standard of "foreseeable relevance", the existing EoI regime already provides necessary flexibility for IRD to accede to such requests.

Enhancing Tax Transparency through Tax Information Exchange Agreements

13. In March 2010, the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes ("the Global Forum")[2] launched a two-phase peer review exercise to evaluate jurisdictions' compliance with the international EoI standard. Phase 1 of the review examines the legal and regulatory framework in each jurisdiction whereas Phase 2 evaluates the implementation of the standard in practice. The Global Forum endorsed in October 2011 the Phase 1 peer review report on Hong Kong, which affirmed our efforts in enhancing tax transparency and concluded that Hong Kong has adequate legal and regulatory framework to facilitate effective EoI. However, the Global Forum recommended that Hong Kong should put in place a legal

[2] Hong Kong is a member of the Global Forum, but not a member of the Peer Review Group.

framework for entering into Tax Information Exchange Agreements ("TIEAs")[3].

14. According to the Global Forum, the latest international standard is that a jurisdiction should make available both CDTA and TIEA as instruments for EoI and that it is a bilateral matter to be discussed between the two jurisdictions concerned as to whether CDTA or TIEA is more suitable. We are given to understand that a number of jurisdictions which were not able to sign TIEA previously have already changed their stance and indicated that they are now willing to sign TIEAs. Therefore, 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, which is scheduled to commence towards the end of 2012.

Consultation with Relevant Stakeholders

15. To take forward the matter of TIEA, we completed in end June 2012 a two-month consultation exercise 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. In this regard, we are mindful of the need to ensure that the interests of relevant stakeholders are well taken care of whilst enabling Hong Kong to better meet the prevailing international standard on EoI so as to preserve Hong Kong's international reputation as a co-operative jurisdiction.

16. Generally, most of the stakeholders that responded support the provision of a legal framework for TIEAs so Hong Kong could avoid being labeled as an uncooperative jurisdiction and the possibility of having sanctions unilaterally imposed on Hong Kong. Notwithstanding, given the benefits of CDTA, they consider that our future priority should remain that of concluding CDTA with Hong Kong's trading and investment partners as well as emerging economies having potential growth in trade and investment with Hong Kong. They are concerned that our efforts to further expand Hong Kong's CDTA network may be jeopardised by the availability of a legal framework for TIEAs. As for taxpayers' rights and confidentiality of information exchanged, the stakeholders are of the view that CDTA and TIEA should have the same safeguards.

[3] Unlike CDTAs, TIEAs provide for EoI mechanism only without double taxation relief. The existing IRO only allows us to enter into tax agreements with other jurisdictions when there is double taxation relief.

Way Forward

17. Given the need for further changes to the existing EoI regime and for putting in place a legal framework for TIEA as set out in the foregoing paragraphs, we plan to introduce legislative proposals to amend the IRO and the Disclosure Rules as appropriate, so as to 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. We propose that the revised EoI regime under the CDTA regime should be applicable to the new regime under TIEA as the EoI arrangement under CDTA and any future TIEA should be on par and in line with the international objective and our commitment to enhance tax transparency. When detailed legislative proposals are available, we will consult the Panel again in the first quarter of 2013. Meanwhile, we will maintain continuous dialogue with relevant stakeholders so as to facilitate exchange of views on the key elements to be incorporated in the detailed legislative proposals.

Advice Sought

18. Members are invited to note and express views on the Administration's efforts to further expand Hong Kong's CDTA network and the proposed way forward in relation to changes to the EoI arrangement.

Financial Services and the Treasury Bureau
October 2012

Annex A

CDTAs that Hong Kong has Signed with Other Jurisdictions (as at 15.10.2012)

CDTAs signed before March 2010

	Jurisdictions	Date of Signing
1	Belgium*	10.12.2003
2	Thailand*	7.9.2005
3	Mainland China*	21.8.2006
4	Luxembourg	2.11.2007
5	Vietnam*	16.12.2008

New CDTAs signed since March 2010

	Jurisdictions	Date of Signing
1	Brunei	20.3.2010
2	Netherlands*	22.3.2010
3	Indonesia	23.3.2010
4	Hungary	12.5.2010
5	Kuwait	13.5.2010
6	Austria	25.5.2010
7	United Kingdom*	21.6.2010
8	Ireland	22.6.2010
9	Liechtenstein	12.8.2010
10	France*	21.10.2010
11	Japan*	9.11.2010
12	New Zealand	1.12.2010
13	Portugal	22.3.2011
14	Spain	1.4.2011
15	Czech Republic	6.6.2011
16	Switzerland*	4.10.2011
17	Malta	8.11.2011
18	Jersey	22.2.2012
19	Malaysia*	25.4.2012
20	Mexico	18.6.2012

* *Among the top 20 trading partners of Hong Kong*

Annex B

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.

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