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Panel on Financial Affairs

Meeting on 4 November 2013

Background brief on creation of a permanent directorate post to support initiatives of expanding the network of exchange of information arrangements of Hong Kong and a supernumerary directorate post to cope with the increase in volume and complexity of work at the Stamp Office of the Inland Revenue Department

Purpose

This paper provides background information on the staffing proposal of creating a supernumerary Chief Assessor ("CA") (D1) post in the Inland Revenue Department ("IRD") in 2011 for the implementation of initiatives relating to the expansion of the Comprehensive Avoidance of Double Taxation Agreement ("CDTA") network of Hong Kong. It also summarizes the major concerns and views expressed by Members during discussions on the staffing proposal in 2011.

Background

Double taxation and tax treaty policy

2. Double taxation, which arises when the same income or profit is subject to tax in more than one jurisdiction, impedes trade, investment and the flow of talent among economies. To avoid this problem, jurisdictions sign bilateral CDTAs to clarify each other's taxing rights. A CDTA normally results in reduced withholding tax rates on passive income such as dividends, royalties and interest and brings tangible benefits to taxpayers.

3. 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 that would hinder cross-border trade and investment. Since then, the Administration has been expanding Hong Kong's CDTA network. According to the Administration, as at 15 September 2013, Hong Kong has signed 29 CDTAs. The list of the relevant jurisdictions is at **Appendix I**.

Article on exchange of information in CDTAs and Tax Information Exchange Agreements

4. 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, 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 2010¹, IRD was enabled to also exercise the information gathering powers and share the information obtained in response to EoI requests made by Hong Kong's CDTA partners for their own tax purposes.

5. 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 on Income and on Capital ("Model Tax Convention") except for certain modifications to address local needs.

6. In order to cope with recent international changes to EoI regime², the Administration introduced the Inland Revenue (Amendment) Bill 2013 into LegCo on 12 April 2013 to enable Hong Kong to enter into standalone Tax Information Exchange Agreements ("TIEAs")³ with other jurisdictions and to enhance EoI arrangements in respect of tax types and limitation on disclosure under CDTAs. The Bill was passed at the Council meeting of 10 July 2013.

¹ 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 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 CDTA partners even when the information is not required for domestic tax purposes. The report of the relevant Bills Committee (LC Paper No. CB(1)755/09-10) was tabled at the Council meeting of 6 January 2010.

² According to the Administration, the Global Forum on Transparency and Exchange of Information for Tax Purposes has launched a two-phase peer review exercise to evaluate jurisdictions' compliance with the international EoI standard. One of the recommendations in the review report of Hong Kong is that Hong Kong should have in place a legal framework for entering into Tax Information Exchange Agreements ("TIEAs"), because the latest international standard on EoI is that a jurisdiction should make available both CDTA and TIEA as EoI instruments with other jurisdictions. It is critical for Hong Kong to have in place the legal framework for TIEAs by mid-2013 before the Global Forum finished the Phase 2 peer review report on Hong Kong in September 2013. OECD also approved in July 2012 an update to the EoI article of its Model Tax Convention and its Commentary.

³ Unlike CDTAs, TIEAs provided for EoI mechanism only without double taxation relief. The existing tax laws in Hong Kong only allowed it to enter into tax agreements with other jurisdictions when there is double taxation relief.

While the Bills Committee generally supported the proposals in the Bill for the purpose of meeting the latest international standard for EoI, members have expressed concerns on a number of issues, including the extent of the relaxation of the limitation on information disclosure, possible additional burden on taxpayers in respect of retention and reporting of tax information, adequacy of the safeguards for protecting taxpayers' privacy and confidentiality of tax information exchanged, use of tax information for non-tax related purposes by CDTA partners, and the Administration's strategies for pursuing CDTAs or TIEAs⁴.

Creation of a supernumerary CA post

7. At the meeting on 1 November 2010, the Administration briefed the Panel on Financial Affairs ("FA Panel") on a staffing proposal to create a supernumerary CA post in IRD from 1 April 2011 for a period of three years to provide directorate support for the implementation of initiatives relating to the expansion of CDTA network of Hong Kong. The staffing proposal was endorsed by the Establishment Subcommittee ("ESC") at the meeting on 12 January 2011 and subsequently approved by the Finance Committee ("FC") at the meeting on 28 January 2011. The main responsibilities of the CA post are –

- (a) to formulate negotiation strategies for CDTAs, supervise preparatory work for CDTA negotiations and lead CDTA negotiations;
- (b) to follow up on the legislative amendments/orders required for implementing CDTAs signed;
- (c) to oversee the adoption of and compliance with the latest EoI standard in CDTAs that Hong Kong entered into, and to safeguard the privacy of taxpayers and confidentiality of information exchanged under the Inland Revenue (Disclosure of Information) Rules, including personally consider and approve/disapprove requests for EoI;
- (d) to coordinate input from relevant bureaux/departments in respect of the peer review by the Global Forum on Transparency and Exchange of Information for Tax Purposes ("the Global Forum") formed under OECD, and assist in the formulation of Hong Kong's responses and act as a focal point for effective communications with the Global Forum during the entire peer review process;

⁴ The report of the Bills Committee (LC Paper No. CB(1)1426/12-13) was tabled at the Council meeting of 10 July 2013.

- (e) to resolve disputes with treaty partners through the Mutual Agreement Procedure (including arbitration) and liaise and negotiate with treaty partners on Advance Pricing Arrangements with multinational companies on the acceptable transfer prices; and
- (f) to represent IRD in international meetings concerning double taxation matters and oversee the overall operation and administration of the Tax Treaty Section.

Deliberation at meetings of the Panel on Financial Affairs, the Establishment Subcommittee and the Finance Committee

8. The major views and concerns expressed by Members on the staffing proposal to create the supernumerary CA post and related issues at meetings of FA Panel, ESC and FC held in 2010 and 2011 are summarized in the ensuing paragraphs.

Justifications for the post

9. Some Members supported the proposal pointing out that the expansion of the CDTA network was in line with global trends and there was a genuine need for a dedicated directorate officer to take up increasing workload and complexities arising from the signing of CDTAs with other jurisdictions. On the other hand, some members expressed reservations over the proposal, including whether the expected increase in workload for negotiating and concluding CDTAs could sufficiently justify creation of the CA post. In particular, given that the Administration had successfully signed CDTAs with different jurisdictions, it should have developed standard strategies and protocols, as well as drawn up a CDTA "template" or "model agreement" for subsequent negotiations to follow, which in turn could reduce the lead time for preparation of CDTA negotiations.

10. The Administration explained that in general IRD needed to take about two months to prepare for CDTA negotiations with another jurisdiction. The IRD officers currently involved in CDTA negotiation work had to undertake other duties. On average, two rounds of meetings had to be held with the contracting partner in negotiating a CDTA. The Administration added that as Hong Kong had now entered into CDTAs with different jurisdictions, it was necessary for Hong Kong to implement these agreements in accordance with the articles provided therein. It was anticipated that CDTA-related workload would increase in different areas, in particular those relating to EoI with other jurisdictions. It was also anticipated that the negotiation of new CDTAs would be more difficult as the counterparts would be new negotiation partners and

more time and efforts would be needed in the preparation and the actual negotiation process. To maintain Hong Kong's competitiveness, there was great urgency for Hong Kong to enter into CDTA with as many jurisdictions as possible. There was hence a genuine need to bring in additional directorate input to steer the CDTA-related work within IRD. The Administration further advised that it was impracticable to apply a model agreement to all CDTAs as some jurisdictions might not want to adopt the same conditions as OECD countries and would seek to make variations by including unique terms and conditions that best suit their interests.

11. At Members' request, the Administration provided information on the current and anticipated workload in relation to CDATs and the major differences between the model agreement adopted by Hong Kong and that of other treaty partners to illustrate the increasing complexity of CDTA negotiations⁵.

Benefits of CDTA

12. Members enquired about the quantitative benefits for Hong Kong from the signing of CDTAs, such as the number of new offices/subsidiaries set up in Hong Kong by companies of the contracting partners of CDTAs and the amount of taxes saved by Hong Kong residents and enterprises as a result of the signing of CDTAs.

13. The Administration responded that it would be difficult to quantify the benefits of CDTAs. While it was generally accepted that CDTAs had led more overseas companies to invest in Hong Kong, and thereby creating more jobs for local people, it would be difficult to vindicate whether the increase of overseas companies in Hong Kong was due to the conclusion of the CDTAs as the decision to invest in Hong Kong would be affected by a host of factors, such as the situations of the global economy and the investment environment. As regards benefits on tax savings to Hong Kong residents and enterprises, the Administration pointed out that it would be difficult to provide such information as Hong Kong residents and enterprises enjoying tax exemption/reduction as a result of the CDTAs were not obliged to report such benefits to the Government. Nonetheless, the Administration provided supplementary information on the benefits that CDTAs would bring to Hong Kong taxpayers and the overall economy⁶.

⁵ The requested information was circulated to Members vide LC Paper No. CB(1)952/10-11(01) and ESC23/10-11(01).

⁶ The requested information was circulated to Members vide LC Paper No. CB(1)952/10-11(01).

Strategy in pursuing CDTAs

14. Members enquired about the Administration's strategy in pursuing CDTAs with other economies, including whether priority would be accorded to Hong Kong's major trading partners in CDTA negotiation work and the target number of CDTAs to be signed.

15. The Administration advised that it was Government's aim to negotiate CDTAs with all Hong Kong's major trading partners but the work had been affected by manpower constraints. On the other hand, some former provisions of IRO had rendered Hong Kong unable to adopt the latest international EoI standard of OECD, which in turn had impaired the incentives of many jurisdictions, in particular OECD countries, to negotiate CDTAs with Hong Kong. This obstacle was relieved with the operation of the Inland Revenue (Amendment) Ordinance 2010 which took effect in March 2010 and enabled Hong Kong to adopt the prevailing international standard on EoI.

Latest development

16. The Administration will brief the FA Panel at the coming meeting on 4 November 2013 on a proposal to create a permanent directorate post upon the lapse of the CA post in March 2014 to provide continued support for expanding the CDTA network and commencing EoI agreements negotiations with jurisdictions not interested in pursuing CDTA. Furthermore, the Administration will consult the FA Panel on a proposal to create a supernumerary directorate post to cope with the increased workload and support various policy initiatives at the Stamp Office of IRD.

Relevant papers

17. A list of relevant papers is given in the **Appendix II**.

List of Jurisdictions with which Hong Kong has entered into CDTAs
(as at 15.9.2013)

	Jurisdictions	Date of Signing (month and year)
1.	Belgium	December 2003
2.	Thailand	September 2005
3.	Mainland China	August 2006
4.	Luxembourg	November 2007
5.	Vietnam	December 2008
6.	Brunei	March 2010
7.	The Netherlands	March 2010
8.	Indonesia	March 2010
9.	Hungary	May 2010
10.	Kuwait	May 2010
11.	Austria	May 2010
12.	The United Kingdom	June 2010
13.	Ireland	June 2010
14.	Liechtenstein	August 2010
15.	France	October 2010
16.	Japan	November 2010
17.	New Zealand	December 2010
18.	Portugal	March 2011
19.	Spain	April 2011
20.	The Czech Republic	June 2011
21.	Switzerland	October 2011
22.	Malta	November 2011
23.	Jersey	February 2012
24.	Malaysia	April 2012
25.	Mexico	June 2012
26.	Canada	November 2012
27.	Italy	January 2013
28.	Guernsey	April 2013
29.	Qatar	May 2013

(Source: Annex D of the LegCo Brief ref. TsyB R 183/800-1-1/94/0 (C) issued on 2 October 2013.)

Appendix II

List of relevant papers

Date	Event	Paper/Minutes of meeting
6 January 2010	The Legislative Council passed the Inland Revenue (Amendment) (No. 3) Bill 2009	Report of the Bills Committee (LC Paper No. CB(1)755/09-10) Sample Exchange of Information Article (LC Paper No. CB(1)106/09-10(02))
1 November 2010	Meeting of the Panel on Financial Affairs	Administration's paper (LC Paper No. CB(1)217/10-11(07)) Minutes (LC Paper No. CB(1)906/10-11) Follow-up paper (LC Paper No. CB(1)952/10-11(01))
12 January 2011	Meeting of the Establishment Subcommittee	Administration's paper (EC(2010-11)15) Minutes (LC Paper No. ESC25/10-11) Follow-up paper (LC Paper No. ESC23/10-11)
28 January 2011	Meeting of the Finance Committee	Minutes (LC Paper No. FC7/11-12)
10 July 2013	The Legislative Council passed the Inland Revenue (Amendment) Bill 2013	Hansard The Bill passed Report of the Bills Committee (LC Paper No. CB(1)1426/12-13)