

For discussion
on 1 November 2010

Legislative Council Panel on Financial Affairs

**Creation of a Supernumerary Post of Chief Assessor
in the Inland Revenue Department**

PURPOSE

This paper briefs Members on the proposed creation of one supernumerary Chief Assessor (“CA”) (D1) post in the Inland Revenue Department (“IRD”) for a period of three years with effect from 1 April 2011 to undertake the implementation of a number of initiatives in relation to the expansion of the Comprehensive Double Taxation Agreement (“CDTA”) network of Hong Kong.

JUSTIFICATIONS

Background

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. It is also common that a CDTA includes an Exchange of Information (EoI) article providing for the exchange of information necessary for the carrying out of the agreement between the two contracting parties.

3. As a business facilitation initiative, the Government has been seeking to sign CDTAs with our trading partners¹ since 1998-99. To

¹ So far, we signed CDTAs with Belgium (2003), Thailand (2005), Mainland China (2006), Luxembourg (2007), Vietnam (2008), Brunei, the Netherlands, Indonesia, Hungary, Kuwait, Austria, United Kingdom, Ireland, Liechtenstein and France (2010). We are also negotiating CDTAs with about 10 economies.

implement the policy, IRD established the Double Taxation Section, renamed as Tax Treaty Section (“TT Section”) in April 2010, manned by a Senior Assessor. However, the then legal constraint on the information gathering power of IRD² was a major obstacle in our CDTA discussions and only a small number of CDTAs were concluded.

4. In view of this, we consulted the business and professional sectors on the liberalisation of EoI under CDTAs in 2005 and 2008. In the 2008 consultation, the trade generally agreed that Hong Kong should align its EoI arrangements with international standards so that we could enter into more CDTAs. The Financial Secretary announced in the 2009-10 Budget the Government’s plan to put forward legislative proposals to align Hong Kong’s EoI arrangements with international standards and to expand our CDTA network. The Inland Revenue (Amendment) Ordinance 2010, which came into operation in March 2010, allows IRD to collect and disclose a taxpayer’s information in response to requests made by our treaty partners even when the information is not required for domestic tax purposes. In other words, we can adopt in our CDTAs the prevailing EoI standard of the Organisation for Economic Cooperation and Development (“OECD”).

Proposed Creation of a Supernumerary CA Post

5. Subsequent to the legislative amendment exercise, we have received positive responses from our trading partners in commencing/resuming CDTA discussions with Hong Kong. To cope with the increasing workload arising from the expansion of our CDTA network, IRD has deployed additional staff to the TT Section through internal redeployment. The organisation of IRD is shown at **Annex A**. The TT Section is currently supported by four professional officers, namely three Senior Assessors and one Assessor with no dedicated supervisory support at the directorate level. All day-to-day supervisory support is now rendered by the Deputy Commissioner of Inland Revenue (Technical) (“DCIR(T)”), who is already fully-stretched by the heavy workload of his other duties. The existing organisation of the TT Section is at **Annex B**.

² Due to the legal constraint, the EoI article that Hong Kong previously adopted in the CDTAs was based on the 1995 version of the Organization for Economic Cooperation and Development (“OECD”) Model Tax Convention while most economies adopt the OECD 2004 version of the EoI article.

6. With the expected challenges ahead as well as substantial increase in workload as set out in paragraphs 7 - 12, we consider that it is justifiable to create a supernumerary CA post, to be offset by the deletion of one non-directorate post, to oversee the TT Section for a period of three years.

(a) Substantial increase in CDTA negotiations

7. In the seven months after the commencement of the legislative amendments in March 2010, we signed ten new CDTAs and one upgrade agreement and concluded four other CDTAs. Besides, we are having CDTA discussions with some ten trading partners. Such progress is remarkable when compared with the conclusion of only five CDTAs in the past decade. It is expected that such negotiation work would increase in the coming years. At present, the negotiation work is shared among the two Deputy Commissioners and the five Assistant Commissioners, who are already heavily loaded with other responsibilities. For better co-ordination, there is an imminent need to have a dedicated directorate officer to take up the formulation and adjustment of negotiation strategies.

(b) Increasing efforts/complexity in the implementation of CDTAs

8. There is a trend that CDTAs are becoming increasingly sophisticated/complex and hence requires more directorate leadership in the course of implementation. For example, some of the CDTAs that we concluded recently contain provisions on arbitration with a view to handling disputes. Under the arbitration mechanism, in case a disputed case arises, an independent arbitration board comprising members from revenue authorities of both sides will be set up to handle the case. Arbitration could be a long and complicated process. We see the need for IRD to be represented by a directorate officer on such arbitration boards given the expertise required and based on protocol considerations.

9. The Inland Revenue (Disclosure of Information) Rules require that the decision on whether to accede to an EoI request has to be made personally by a directorate officer authorised by the Commissioner of Inland Revenue so as to safeguard the privacy of taxpayers and the confidentiality of information exchanged. Besides, it is an international practice that EoI is completed within 90 days upon request. Hence, there

is strong call for prompt and close supervision by a dedicated directorate officer on the carrying out of the proper statutory procedures before the information is sent out. With the increasing number of CDTAs entering into force, the number of disclosure requests received by IRD is expected to grow. For example, a developed economy in the North East Asia with a network of 50 treaty partners normally receives an average of 100 EoI requests each year.

10. Apart from the above, the newly established Global Forum on Tax Transparency and Effective Exchange of Information under the auspices of OECD, of which Hong Kong is a member, will conduct peer reviews on Hong Kong in the first half of 2011 and the second half of 2012 respectively to assess whether Hong Kong meets the international standard on EoI. With such international dimension, it is imperative that IRD devotes more resources at the directorate level to handle EoI requests.

(c) Increased participation in international exchanges on taxation matters

11. Over the years, there has been a significant increase in IRD's international involvement in double taxation matters, including the new Global Forum on Tax Transparency and Effective Exchange of Information, the Forum on Tax Administration at Commissioner level and OECD annual meetings in Paris on development of the Model Tax Convention. Active participation in all these international fora is instrumental to demonstrate our commitment to tax transparency. Liaison with the tax authorities of our treaty partners, including the State Administration of Taxation (SAT), is also becoming more frequent than ever. Hence, there is a need for dedicated directorate support in the co-ordination of efficient liaison work as well as timely responses to any new developments at the global level.

(d) Delivery of new area of work related to CDTAs

12. In the coming year, IRD proposes to embark on the initiative of entering into Advance Pricing Arrangements ("APAs") with multinational companies. APAs are unilateral or multilateral arrangements made between taxpayers and the tax authority(/ies) in advance on the set of criteria for the determination of transfer pricing for cross-border transactions between related companies. APAs avoid double taxation in

advance, resolve transfer pricing issues and provide predictability for taxpayers. In processing APA requests, substantial information has to be collected and examined, including comparable pricing information, methodology and critical assumptions. With a strengthened TT Section, IRD could work on APAs which often invariably involve intensive and highly-technical negotiations with treaty partners. A network of such APAs would be beneficial to Hong Kong's position as a regional headquarters for multinational companies and a platform for overseas investment into the Mainland.

ORGANISATION

13. The proposed CA post will be designated as CA(TT) and the incumbent will report to DCIR(T). The proposed organisational structure of the TT Section is shown at **Annex C**. The proposed job description of CA(TT) is at **Annex D**.

ALTERNATIVE CONSIDERED

14. We have critically examined the feasibility of internal redeployment of a CA to take up the new responsibilities. However, all existing CAs are already fully engaged in their existing schedules. None of them has spare capacity to lead the TT Section without adversely affecting the discharge of their current duties. If the proposed CA post is not created, DCIR(T), who is already fully stretched by the heavy workload of his duties, would have to continue supervising the day-to-day business of the TT Section. This would hinder Hong Kong's progress in concluding and implementing CDTAs.

FINANCIAL IMPLICATIONS

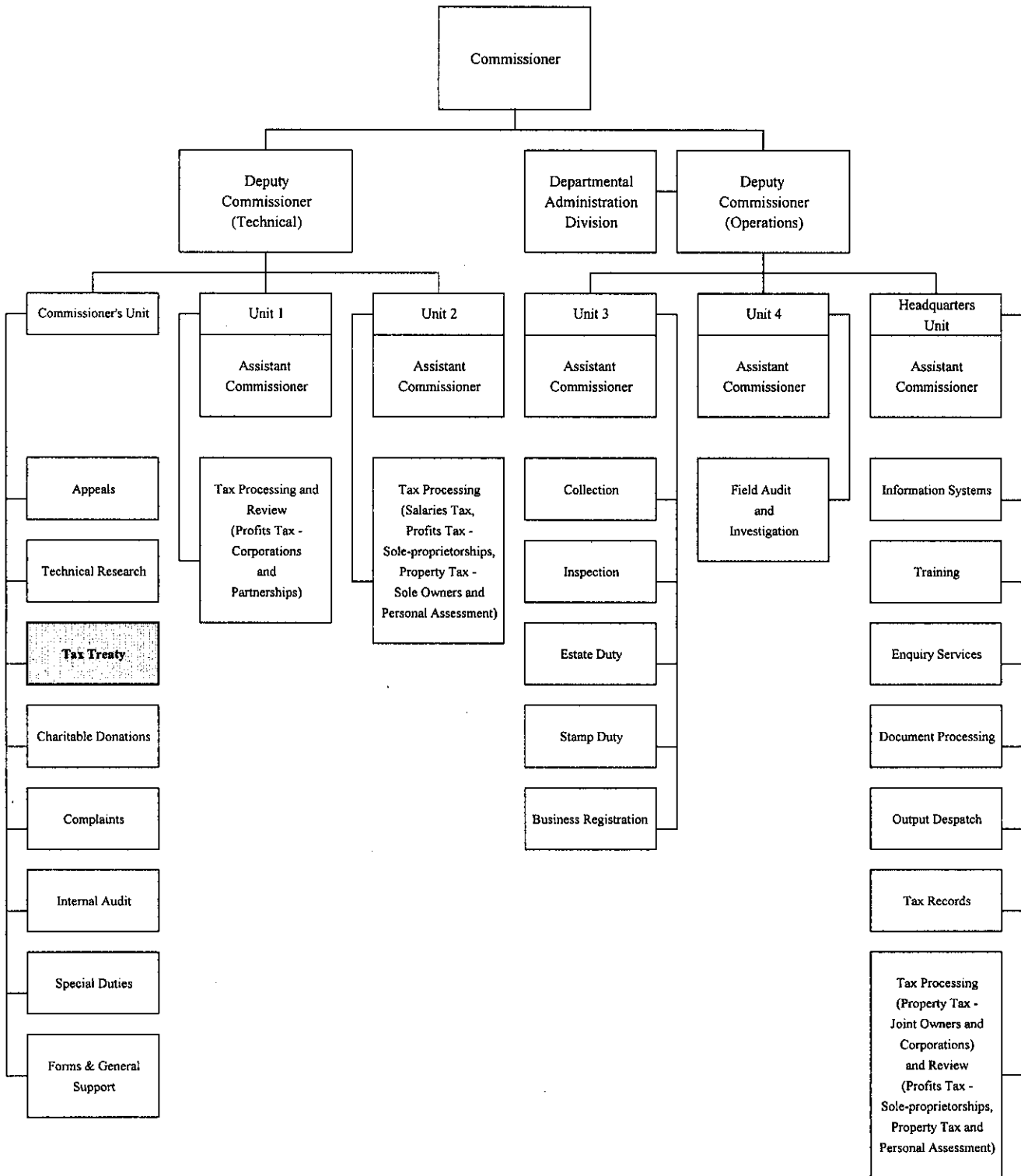
15. The proposed creation of a supernumerary CA post will bring about an additional notional annual salary at mid-point of \$1,265,400. The full annual average staff cost, including salaries and on-cost, is \$1,621,000. The cost of the proposed CA post will be met within IRD's approved allocations.

WAY FORWARD

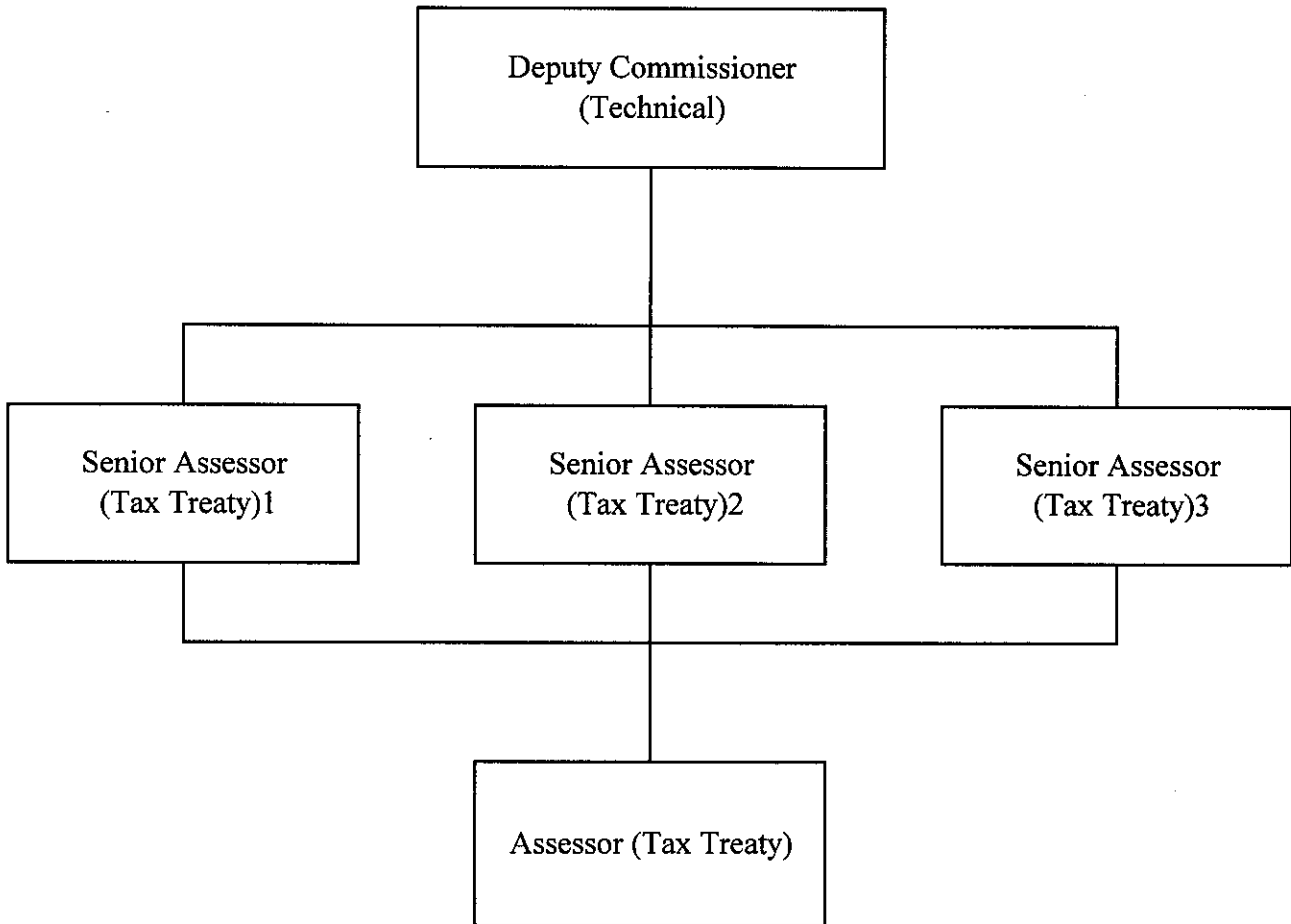
16. We plan to submit the proposal to the Legislative Council Establishment Sub-committee on 5 January 2011 for recommendation to the Finance Committee for approval on 28 January 2011.

Financial Services and the Treasury Bureau
October 2010

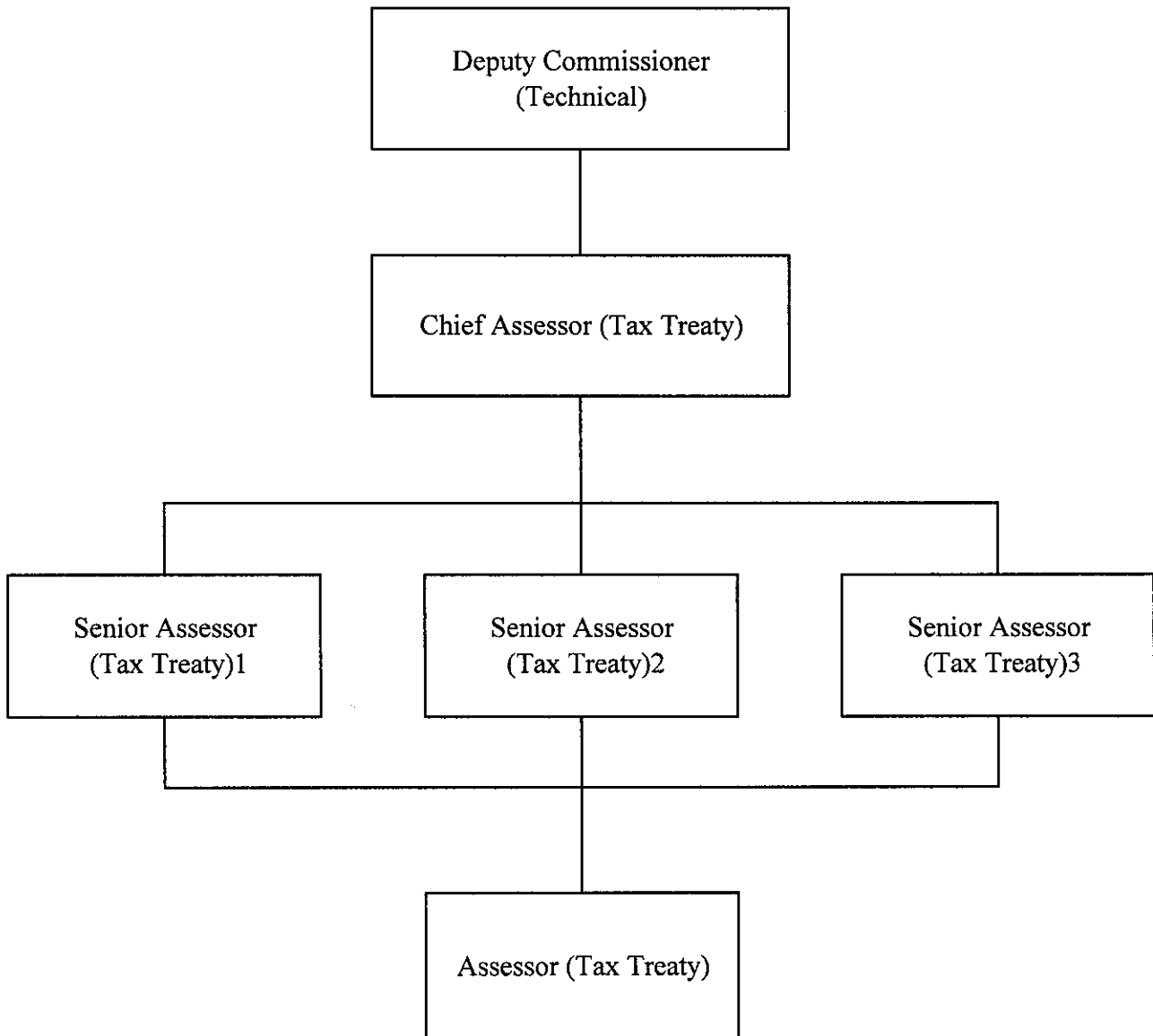
**Existing Organisation Chart of Inland Revenue Department
(as at October 2010)**



Existing Organisation Chart of Tax Treaty Section
(as at October 2010)



Proposed Organisation Chart of Tax Treaty Section
(as at April 2011)



**Proposed Job Description
Chief Assessor (Tax Treaty)**

Rank : Chief Assessor (D1)

Responsible to : Deputy Commissioner (Technical) [DCIR(T)]

Main Duties and Responsibilities –

1. To update the model Comprehensive Double Taxation Agreement (“CDTA”) of Hong Kong in consultation with the Financial Services and the Treasury Bureau, supervise the preparatory work for CDTA negotiations, lead the negotiations and formulate negotiation strategies.
2. To vet draft Inland Revenue (Double Taxation Relief and Prevention of Fiscal Evasion with respect to Taxes on Income) Orders for submission to the Executive Council and the Legislative Council.
3. To oversee the adoption of and compliance with the latest Exchange of Information (“EoI”) standards in CDTAs entered in by the Hong Kong Special Administrative Region Government.
4. To safeguard the privacy of taxpayers and confidentiality of information exchanged under Inland Revenue (Disclosure of Information) Rules; personally consider and approve/disapprove the requests for EoI having regard to the proper statutory procedures.
5. To resolve disputes with treaty partners through the Mutual Agreement Procedure (including arbitration) and liaise and negotiate with the treaty partners on the Advance Pricing Arrangements with multi-national companies on the acceptable transfer prices.
6. To represent IRD in international meetings concerning double taxation regime and oversee the overall operation and administration of the Tax Treaty Section.