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Bills Committee on Inland Revenue (Amendment) Bill 2013

Background brief prepared by the Legislative Council Secretariat

Purpose

This paper provides background information on the Inland Revenue (Amendment) Bill 2013. It also summarizes the major views and concerns expressed by members of the Panel on Financial Affairs ("FA Panel") during discussion on matters related to the Bill at meetings held in 2009, 2012 and 2013.

Background

Tax treaty policy

2. In the 1998-1999 Budget, the then Financial Secretary announced that the Government would actively negotiate comprehensive avoidance of double taxation agreements ("CDTAs") with its major trading and economic partners, which served as a business facilitation initiative to minimize the incidence of double taxation¹ 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. Up to end of April 2013, Hong Kong has signed 28 CDTAs as listed in **Appendix I**.

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 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 2010², 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 on Income and on Capital (**Appendix II**) except for certain modifications to address local needs. 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 will only exchange information that does not relate to any period before the relevant provisions of the relevant CDTA come into effect;
- (e) information received by treaty partners should be treated as confidential;

² 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>.

- (f) information will only be disclosed to the tax authorities (including courts and administrative bodies) concerned with the assessment or collection of, the enforcement or prosecution in respect of and the determination of appeals in relation to taxes falling within the scope of EoI but not for release to their oversight bodies unless there are legitimate reasons given by the treaty partners;
- (g) information requested shall not be disclosed to a third jurisdiction;
- (h) 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; and
- (i) requests from treaty partners for tax examinations abroad and assistance in collection of taxes will not be acceded to.

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. The Administration has indicated the need to at least adopt a minimum necessary approach to enhance the EoI arrangement under CDTA so that it could catch up with the prevailing international EoI standard.

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, Mexico and Italy have raised grave 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 the jurisdictions 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 administration and enforcement after the relevant provisions of the CDTA came into effect.

Recent developments in international EoI standard

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 review³ 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")⁴ 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. According to the Administration, it is critical for Hong Kong to have in place the legal framework for TIEAs by mid-2013 before the Global Forum finishes the Phase 2 peer review report on Hong Kong in September 2013. Failing the

³ 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.

⁴ 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.

Phase 2 peer review will run Hong Kong into the risk of being labeled as an uncooperative jurisdiction, which is highly undesirable for Hong Kong's international reputation and may in turn undermine its position and competitiveness as an international business and financial centre. Other jurisdictions may also impose unilateral sanctions on Hong Kong.

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. A new requirement featured by the 2012 version was 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. It is the Administration's intention to abide by this new requirement, taking into account that Hong Kong's domestic legislation already required any persons with knowledge or suspicion, including IRD officers, to disclose confidential information to authorized officers of law enforcement agencies designated under the relevant legislation to enable them to perform their duties thereunder.

Consultation with relevant stakeholders

10. According to the Administration, it completed at the end of 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. The Administration conducted a further round of briefing and consultation sessions from November 2012 to January 2013 with various stakeholders, including tax and accountants' associations, banking and insurance associations, as well as chambers of commerce. According to the Administration, various stakeholders generally supported the proposed approach to enhance the EoI under CDTA framework and to put in place a legal framework for TIEA.

Inland Revenue (Amendment) Bill 2013

11. In order to enable Hong Kong to enter into standalone TIEAs with other jurisdictions and to enhance the EoI arrangements in respect of tax types and limitation on disclosure under CDTAs, the Administration introduced the Inland Revenue (Amendment) Bill 2013 into the Legislative

Council ("LegCo") on 12 April 2013. The main provisions of the Amendment Bill are --

- (a) to amend section 49 of the IRO so that arrangements may be made with the government of a territory outside Hong Kong not only for affording relief from double taxation, but also for exchanging information in relation to any tax imposed by the laws of Hong Kong or the territory;
- (b) to amend sections 51 and 52 of the IRO respectively to clarify that the power under those sections to obtain information is exercisable not only in respect of information possessed by a person, but also in respect of information in a person's control;
- (c) to amend section 4 of the Disclosure Rules to enable the Commissioner of Inland Revenue ("CIR") to disclose information that relates to the carrying out of the relevant arrangements, or to tax assessment, in respect of any period that starts after the arrangements have come into operation; and
- (d) to make consequential amendments to section 51B of IRO and the Schedule to the Disclosure Rules.

12. At the House Committee meeting held on 26 April 2013, Members agreed to form a bills committee to study the Inland Revenue (Amendment) Bill 2013.

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. Members were briefed on the detailed legislative proposals to enhance EoI arrangements for tax purposes on 4 February 2013. Major views and concerns expressed by members are summarized in the ensuing paragraphs.

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

14. 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 unilateral sanctions on Hong Kong or negative impact on the diplomatic relations between Hong Kong and other jurisdictions. 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.

15. A member expressed concern about the practicability to trace and exchange tax information that was generated a long time ago before the effective date of the relevant CDTA/TIEA agreements, and suggested that, instead of relaxing the disclosure limitation, treaty partners should make preparation in the transitional period before the CDTA/TIEA took effect, such that the information to be exchanged for tax purposes would only cover those after the effective date of the relevant provisions of CDTA/TIEA.

16. The Administration advised that the latest international standard for EoI arrangements was reflected in the 2012 version of EoI article of OECD's Model Tax Convention and its Commentary. Hong Kong would only meet the minimum requirements even if the legislative proposals were passed. For instance, Hong Kong would still not entertain requests for tax information relating to retrospective tax assessments; tax examinations abroad; and assistance in the collection of taxes which were considered as desirable in the 2012 version of the OECD's Model Tax Convention and its Commentary. The Administration further emphasized that the current proposal still upheld the policy of no retrospectivity for EoI as it only relaxed the limitation on disclosure slightly by allowing CIR to disclose information in response to an EoI request only if he was satisfied that such information related to tax assessments in respect of any period after the date on which the relevant CDTA/TIEA came into operation.

17. 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.

Privacy protection

18. 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. There were also worries among small and medium-sized enterprises about the potential impacts of the exchange of information relating to their business operations. 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.

19. The Administration further stressed that information exchange was conducted on a case-specific basis and prudent 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. The Administration supplemented that, if treaty partners were considered to have violated their obligations, including the confidentiality requirements, Hong Kong would, if warranted, take necessary action against the treaty partner in question, including termination of the relevant CDTA/TIEA.

20. As to whether the taxpayer concerned would be informed of the request for information on his case, the Administration advised that CIR was required to inform the taxpayer concerned of the disclosure request from CDTA or future TIEA partners. The taxpayer might request a copy of the information that CIR was prepared to disclose, and amend the information if it was factually incorrect. The Disclosure Rules also provided for a review system in handling appeals, whereby the taxpayer in

question might request FS to direct CIR to make the amendments to the information to be disclosed.

Relevant papers

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

Council Business Division 1
Legislative Council Secretariat
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**Jurisdictions which have concluded Comprehensive Avoidance of
Double Taxation Agreements (CDTAs) with Hong Kong
(as at end of April 2013)**

Jurisdictions		Year of signature of agreement
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
27.	Italy*	2013
28.	Guernsey	2013

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

**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: Annex C to Legislative Council Brief on Inland Revenue (Amendment) Bill 2013
(File Ref.: TsyB R 183/700-6/4/0(C))

Appendix III

List of relevant papers

Date	Event	Paper/Minutes of meeting
4 May 2009	Meeting of the Panel on Financial Affairs ("FA Panel")	<u>Discussion paper</u> (LC Paper No. CB(1)1408/08-09(03)) <u>Minutes</u> (LC Paper No. CB(1)2092/08-09)
24 June 2009	-	<u>Legislative Council Brief on Inland Revenue (Amendment) (No.3) Bill 2009</u> (FIN CR 12/2041/46)
6 January 2010	Council meeting	<u>Report of the Bills Committee on Inland Revenue (Amendment) (No.3) Bill 2009</u> (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	<u>Hansard</u> (pages 82 to 85)
July 2012	-	<u>Information paper provided by the Administration on "Comprehensive Avoidance of Double Taxation Agreements"</u> (LC Paper No. CB(1)2381/11-12(01))
5 November 2012	Meeting of the FA Panel	<u>Discussion paper</u> (LC Paper No. CB(1)91/12-13(04)) <u>Information note</u> (LC Paper No. IN03/12-13) <u>Minutes</u> (LC Paper No. CB(1)359/12-13)

Date	Event	Paper/Minutes of meeting
4 February 2013	Meeting of the FA Panel	<u>Discussion paper</u> (LC Paper No. CB(1)484/12-13(05)) <u>Background brief</u> (LC Paper No. CB(1)484/12-13(06)) <u>Minutes</u> (LC Paper No. CB(1)930/12-13)
10 April 2013	-	<u>Legislative Council Brief on Inland Revenue (Amendment) Bill 2013 issued by the Financial Services and the Treasury Bureau</u> (File Ref.: TsyB R 183/700-6/4/0(C))