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**Subcommittee on Inland Revenue (Exchange of Information relating to Taxes)
(United States of America) Order**

Background Brief

Purpose

This paper provides background information on the Inland Revenue (Exchange of Information Relating to Taxes) (United States of America) Order ("the Order"). It also summarizes the views and concerns expressed by Members when issues related to tax information exchange agreement ("TIEA") were discussed by the committees of the Legislative Council ("LegCo") in 2009 to 2013.

Background

Policy on TIEA

2. It has been the Government's policy priority to conclude comprehensive agreements for avoidance of double taxation ("CDTAs") with Hong Kong's trading and investment partners which serve as a business facilitation initiative to minimize the incidence of double taxation¹. Thus, CDTAs facilitate the flow of trade, investment and talent between Hong Kong and the rest of the world, as well as enhance Hong Kong's position as an international business and financial centre. All CDTAs signed embody a mechanism for exchange of tax information ("EoI") up to the international standard as far as practicable.

3. According to the Global Forum on Transparency and Exchange of Information for Tax Purposes ("Global Forum") of the Organization for Economic Cooperation and Development ("OECD"), a jurisdiction should make

¹ Double taxation is generally defined as the imposition of comparable taxes in two or more places on the same taxpayers in respect of the same subject matter for identical periods.

available both CDTA and TIEA as instruments for EoI with other jurisdictions. TIEA is a form of agreement for EoI which carries no double taxation relief. The prevailing international standard is that the preference for CDTA over TIEA cannot be reason for refusing to enter into an EoI agreement with relevant partners.

4. During an earlier review of Hong Kong's compliance with the international EoI standard, the Global Forum recommended that Hong Kong should put in place a legal framework for entering into TIEAs with other jurisdictions, otherwise Hong Kong would run the risk of being labelled as an uncooperative tax jurisdiction.

Inland Revenue (Amendment) (No. 2) Ordinance 2013

5. On 12 April 2013, the Administration introduced the Inland Revenue (Amendment) Bill 2013 into LegCo to amend the Inland Revenue Ordinance (Cap. 112) ("IRO") to enable Hong Kong to enter into standalone TIEAs with other jurisdictions and enhance EoI arrangements in respect of tax types and limitation on disclosure under CDTAs. The Bill was passed by LegCo at the meeting of 10 July 2013 and enacted as the Inland Revenue (Amendment) (No. 2) Ordinance 2013.

The United States Foreign Account Tax Compliance Act

6. The United States of America ("US") Foreign Account Tax Compliance Act ("FATCA") passed by the Congress in 2010 will take effect from 1 July 2014. Essentially, FATCA requires (a) US persons, including those who live outside US, to report to the US tax authorities their financial accounts held in other jurisdictions; and (b) foreign financial institutions, including those in Hong Kong, to report the financial information in respect of their US clients. It is necessary for Hong Kong to enter into an intergovernmental agreement ("IGA") with US to lay down the arrangements which help facilitate compliance by the financial institutions in Hong Kong with FATCA requirements.

The Inland Revenue (Exchange of Information relating to Taxes) (United States of America) Order

7. As advised by the Administration, the IGA to be signed with US in relation to FATCA must be underpinned by an EoI agreement (either under CDTA or TIEA) as the necessary basis for Hong Kong to process EoI requests made by the US tax authorities in relation to the information reported by financial institutions in Hong Kong to US under FATCA. As US has all along shown no interest in pursuing a CDTA with Hong Kong, and to facilitate the early conclusion of the IGA with US before the implementation of FATCA in

July 2014, the Government entered with US on 25 March 2014 an agreement between the Hong Kong Special Administrative Region and US for the Exchange of Information relating to Taxes ("the US Agreement"). It is the first TIEA concluded by Hong Kong with other jurisdictions.

8. The Order is made by the Chief Executive in Council under section 49(1A) of IRO to give effect to the US Agreement. The Order was published in the Gazette on 25 April 2014 and tabled at LegCo meeting of 30 April 2014 for negative vetting. The Order will come into operation on 20 June 2014.

9. The US Agreement adopted the OECD 2002 version of TIEA model except for certain modifications to address local needs. The tax types² covered by the US Agreement are –

- (a) federal taxes on income;
- (b) federal taxes related to employment and self-employment;
- (c) federal estate and gift taxes; and
- (d) federal excise taxes.

10. According to the Administration, the TIEA partner (the US in the present case) will have to lodge EoI requests to the competent authority of Hong Kong (i.e. the Inland Revenue Department ("IRD")) if it wishes to obtain information from Hong Kong under the EoI arrangement of TIEA. Upon receipt of an EoI request, IRD will examine, with reference to the particulars provided by US, whether the information requested is foreseeably relevant according to the conditions laid down in the US Agreement and in the Inland Revenue (Disclosure of Information) Rules (Cap. 112 sub. leg. BI) ("the Disclosure Rules"). If the conditions are not fulfilled, IRD will not approve the EoI request. Even when IRD acts on a valid EoI request and exercises its information-gathering power to approach a person for the requested information, that person has no obligation to provide to IRD, for EoI purposes, information which is not in his/her possession or control and is not required to be kept or is beyond the statutory retention period under IRO.

11. In order to protect taxpayers' privacy and confidentiality of information exchanged, the Administration adopted a number of safeguard measures in TIEAs, same as those for CDTAs. The safeguard measures included in the US Agreement are set out in **Appendix I**.

² Following the enactment of the Inland Revenue (Amendment) (No.2) Ordinance 2013, the coverage of tax types for the purpose of EoI under CDTAs/TIEAs has been relaxed to the effect that EoI will no longer be restricted to income taxes. The US Agreement has also adopted a positive listing approach to set out the tax types covered.

Concerns and views expressed by Members

12. The major views and concerns on issues relating to the TIEA regime and operation of the EoI mechanism expressed by Members at meetings of the Panel on Financial Affairs in 2009, 2012 and 2013, during the scrutiny of the Inland Revenue (Amendment) Bill 2013 and the three Orders made under section 49(1A) of IRO and gazetted on 4 October 2013 to implement the CDTAs entered between Hong Kong and Guernsey, Italy and Qatar respectively are summarized in the ensuing paragraphs.

Benefits of TIEAs and possible additional burden to Hong Kong taxpayers

13. Noting that TIEAs would bring no double taxation relief but would involve the provision of confidential information of taxpayers to other tax jurisdictions, some Members expressed concern about the benefits for Hong Kong in entering into TIEAs with other jurisdictions and the possible burden on Hong Kong taxpayers on retention and reporting of tax information.

14. The Administration explained that the introduction of the TIEA framework was essential to Hong Kong's international reputation and competitiveness. Without a legal framework for TIEAs, Hong Kong might run the risk of being labelled as an uncooperative jurisdiction, which in turn would undermine its position and competitiveness as an international business and financial centre. The Administration stressed that it would only disclose the relevant information requested according to the provisions of CDTAs/TIEAs and the laws of Hong Kong, and would not make any investigation or take enforcement actions on behalf of tax authorities of other jurisdictions.

Scope of information disclosure and privacy protection

15. On the disclosure of tax information generated prior to the effective date of the relevant CDTA or TIEA, some Members expressed concern that this might lead to compulsory disclosure of information generated longer than the existing requirement on taxpayers to retain business records for seven years under sections 51C and 51D of IRO. Some Members considered that the Administration should consider restricting disclosure of information to that generated within seven years prior to the effective date of the relevant CDTA/TIEA.

16. The Administration explained that when conducting EoI, it had all along adopted a policy of imposing a limitation on the information to be exchanged. That is, the information disclosed to CDTA/TIEA partners must relate to the carrying out of the provisions of the relevant CDTA/TIEA or the administration or enforcement of the tax laws of the CDTA/TIEA partner concerning taxes

imposed in the periods after the provisions of the CDTA/TIEA came into effect. In respect of the concern about burden on taxpayers in the retention of records to beyond seven years, the Administration advised that it had no plan to change the existing record-keeping requirements under sections 51C and 51D of IRO.

17. Some Members raised concerns about protection of the confidentiality of the tax information exchanged with another jurisdiction, and the safeguards to be put in place under CDTAs/TIEAs to ensure that only legitimate and justifiable requests would be entertained.

18. The Administration advised that each CDTA/TIEA signed would be implemented as subsidiary legislation domestically, subject to negative vetting by LegCo. The existing Disclosure Rules, providing for domestic statutory safeguards in addition to those provided in individual agreements, would be applicable to EoI under CDTAs/TIEAs. The Administration 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/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.

19. As to whether the taxpayer concerned would be informed of the request for information on his case, the Administration advised that the Commissioner of Inland Revenue ("CIR") was required to inform the taxpayer concerned of the disclosure request from CDTA or 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 the Financial Secretary to direct CIR to make the amendments to the information to be disclosed.

20. Regarding Members' enquiry whether taxpayers could challenge the Administration on inappropriate disclosure of tax information to be exchanged, the Administration responded that a person may challenge the validity of the decision in respect of a disclosure request made under the Disclosure Rules, including approval of a disclosure request, permission to waive particulars in the Schedule to the Disclosure Rules, and partial approval or refusal of amendments to information to be disclosed, by way of an application to court for a judicial review. The Administration stressed that the particulars to be contained in an EoI request as set out in the Schedule to the Disclosure Rules, including the statement about the relevance of the information to the purpose of

the request to be made by the requesting party, together with the legal status of the Rules, should provide adequate protection to the concerned taxpayers.

21. In response to some Members' views for the Administration to set up an independent oversight body to ensure the handling of individual EoI requests by IRD in a fair and consistent manner and strict adherence of IRD's actions and decisions to the internal procedures and guidelines, the Administration advised that IRD would extend the ambit of its Users' Committee, which comprised members from various sectors including legal practitioners, tax practitioners and academics and met quarterly to review the services of IRD, to cover the performance of IRD in respect of the handling of EoI matters. IRD would provide report on its compliance in respect of EoI to the Users' Committee on a regular basis. However, there were comments from Members that expansion of the ambit of the Users' Committee, which would not deal with confidential information and had no role in conducting reviews on individual cases, could not address the concern.

Handling of EoI requests

22. Some Members considered that when IRD responded to EoI requests from CDTA partners and gather information from the subject person or a relevant third party (i.e. the information holder) who held the relevant information or documents, it should provide information on the identity of the requesting jurisdiction to allow the information holder to protect its interests. For instance, the information holder concerned could take appropriate actions with the relevant jurisdiction, such as taking legal action (e.g. against self-incrimination) to defend its rights by refusing to produce the information or documents that were sought by the requesting jurisdiction concerned.

23. In view of Members' concern and after striking a balance between the international standards/practices and information holders' interest, the Administration agreed to adopt a pragmatic approach to deal with the situation. Specifically, where the information holder requests to know the name of the requesting jurisdiction upon receipt of IRD's formal notice for information, IRD would approach the competent authority of the requesting jurisdiction and put forward the information holder's request. Should the competent authority of the requesting jurisdiction raise any objection, IRD will then let the information holder know accordingly. If the information holder refuses to provide the information requested as he/she does not know the name of the requesting jurisdiction, IRD will, having considered the circumstances of the case, decline the EoI request for reason that it could not disclose to the information holder the name of the requesting jurisdiction, which is considered necessary to facilitate the gathering of the requested information. The Administration also undertook to update the relevant Departmental Interpretation and Practice Notes on the EoI

under CDTAs to set out the procedures to be followed by IRD officers in processing EoI requests.

Strategies for pursuing CDTAs or TIEAs and review of CDTAs

24. Some Members opined that the Administration should uphold its policy of giving greater priority to negotiation of a CDTA than a TIEA and only consider signing a TIEA when concluding a CDTA was not an option. The Administration responded that given the benefits of CDTAs, it would remain a policy priority to seek to conclude CDTAs with Hong Kong's trading and investment partners. As it was the international standard that preference for CDTA over TIEA could not be a reason for refusing to enter into an EoI agreement, while the Administration would continue its efforts in persuading trading and investment partners to pursue CDTAs with Hong Kong, it could not preclude the possibility of entering into TIEAs but not CDTAs with some jurisdictions.

25. The Administration was requested to conduct regular reviews of the CDTAs/TIEAs that Hong Kong had entered/would enter into in order to ensure that Hong Kong taxpayers' interests were not adversely affected by the agreements. The Administration advised that IRD would keep under constant review the relevant agreements and stood ready to raise with the competent authorities of the CDTA/TIEA partners any particular issues arising from the implementation of the agreements.

Latest development

26. At the House Committee meeting on 2 May 2014, Members agreed to form a subcommittee to study the Order.

Relevant papers

27. A list of relevant papers is in **Appendix II**.

Safeguard measures to protect taxpayers' privacy and confidentiality of information exchange under the Agreement between the Hong Kong Special Administrative Region ("HKSAR Government") and the United States of America ("US") for the Exchange of Information relating to Taxes ("EoI")

- (a) the HKSAR Government only exchanges information upon receipt of requests and no information will be exchanged on an automatic or spontaneous basis;
- (b) the information sought should be foreseeably relevant to the administration and enforcement of domestic tax laws of the Contracting Parties, i.e. no fishing expedition;
- (c) information generated before the effective date of the relevant the Tax Information Exchange Agreement ("TIEA") can be disclosed to the TIEA partner only if the standard of foreseeable relevance is satisfied upon examination of the particulars provided by the TIEA partner in its request for EoI, and the requested information relates to the carrying out of the relevant TIEA or the administration or enforcement of the tax laws of the TIEA partner concerning taxes imposed in periods after the TIEA becomes effective;
- (d) information received by the TIEA partners should be treated as confidential;
- (e) information would only be disclosed to the persons or 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 TIEA partners and where applicable, such oversight bodies should be positively listed in the relevant TIEA or its protocol. Upon the US' request, the US Agreement specifically provides that the US competent authority (i.e. the US Treasury) may disclose information received under the agreement to administrative bodies that are authorized to review tax return information under its domestic confidentiality laws, covering bodies whose duties include auditing the tax authority (the Treasury Inspector General for Tax Administration and the congressional Government Accountability Office) and bodies whose duties require inquiries into tax administration for planning tax law enactments and implementation and proposing tax law changes (the Office of the Treasury Assistant Secretary for Tax Policy and the tax-writing committees in Congress);

- (f) information received should not be disclosed to a third jurisdiction;
- (g) 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 is not obtainable under the laws of the requesting party for the purposes of the administration or enforcement of its own tax laws, including information that would be covered by legal professional privilege, etc.; and
- (h) the HKSAR Government will not accede to any requests for tax examinations abroad, i.e. representatives of one Contracting Party will not be permitted to conduct tax examinations in the territory of another Contracting Party.

(*Source* : Adapted from paragraph 10 of the Legislative Council brief (File Ref: TsyB R 183/800-1-1/4/0 (C))

List of relevant papers

Date	Event	Papers/Minutes of meeting
4 May 2009	The Panel on Financial Affairs ("FA Panel") discussed the extension the network of agreements for avoidance of double taxation	Discussion paper (LC Paper No. CB(1)1408/08-09(03)) Minutes of meeting (LC Paper No. CB(1)2092/08-09)
5 November 2012	FA Panel was briefed by the Administration on its policy regarding the exchange of tax information with other jurisdictions	Administration's paper (LC Paper No. CB(1)91/12-13(04)) Minutes (LC Paper No. CB(1)359/12-13)
4 February 2013	FA Panel was briefed by the Administration on the detailed legislative proposals to enhance the exchange of information arrangements for tax purposes.	Administration's paper (LC Paper No. CB(1)484/12-13(05)) Minutes (LC Paper No. CB(1)930/12-13)
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)
October and November 2013	The Subcommittee studied the three Orders made under section 49(1A) of the Inland Revenue Ordinance and gazetted on 4 October 2013 for implementing the comprehensive agreements for avoidance of double taxation entered between Hong Kong and Guernsey, Italy and Qatar	Report of the Subcommittee (LC Paper No. CB(1)350/13-14)