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Subcommittee on the Six Orders Made under Section 49(1A) of the Inland Revenue Ordinance and Gazetted on 2 October 2015

Background Brief

Purpose

This paper provides background information on the six orders made under the Inland Revenue Ordinance (Cap.112) ("the Six Orders") and gazetted on 2 October 2015 (L.N. 183 to L.N. 188) to implement the Tax Information Exchange Agreements ("TIEAs") entered between Hong Kong and Denmark, the Faroes, Greenland, Iceland, Norway and Sweden respectively. It also summarizes the views and concerns expressed by Members when issues related to TIEA were discussed by the committees of the Legislative Council ("LegCo") since the legislative session 2008-2009.

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.

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.

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 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 a two-phase review of Hong Kong's compliance with the international EoI standard in 2010, 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 types² 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 Inland Revenue (Exchange of Information relating to Taxes) (United States of America) Order

6. The United States of America ("US") Foreign Account Tax Compliance Act ("FATCA") was passed by the Congress in 2010 and has taken effect since 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 IGA 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.

² Following the enactment of the Inland Revenue (Amendment) (No. 2) Ordinance 2013, the coverage of tax type for the purposes of EoI under CDTAs/TIEAs has been relaxed to the effect that the EoI will no longer be restricted to income taxes.

7. The Government entered with US on 25 March 2014 an agreement for EoI ("the US Agreement"). This is the first TIEA concluded by Hong Kong with other jurisdictions³.

Automatic exchange of financial account information in tax matters

8. At present, Hong Kong is only able to exchange tax information upon request with its treaty partners under either CDTAs or TIEAs. For the purpose of enhancing tax transparency and combating cross-border tax evasion, OECD released in July 2014 the "Standard for Automatic Exchange of Financial Account Information in Tax Matters" calling on governments to collect from financial institutions financial account information of non-domestic tax residents and exchange the information with jurisdictions of residence of account holders on an annual basis.

9. Automatic exchange of financial account information ("AEOI") involves systematic and periodic transmission of financial account information by the source jurisdiction to the jurisdiction of residence of the account holders concerning all types of investment income, account balances or values, and sales proceeds from financial assets on an annual basis. "Automatic exchange" does not mean that there will be free flow of information to all other jurisdictions. The exchange is conducted within the confine of an EoI agreement signed between the tax authorities of two or more jurisdictions.

10. On 15 September 2014, the Administration indicated to the Global Forum Hong Kong's support for implementing the new standard on a reciprocal basis, with appropriate partners, with a view to commencing the first information exchange by end of 2018. As advised by the Administration, its initial thinking is to amend IRO to put in place the necessary enabling provisions for AEOI and to make use of the bilateral EoI instruments (i.e. CDTA or TIEA) as the legal basis for implementing AEOI. This means that Hong Kong's future AEOI partner must either be its CDTA or TIEA partner. The Administration launched a public consultation on 25 April 2015 to gauge views on how Hong Kong should apply the new standard. The consultation ended on 30 June 2015.

The Six Orders gazetted on 2 October 2015

11. L.N. 183 to L.N. 188 are made by the Chief Executive in Council under section 49(1)A of IRO to give effect to TIEAs entered into with the six Nordic

³ The Inland Revenue (Exchange of Information relating to Taxes) (United States of America) Order (L.N. 54 of 2014) is made by the Chief Executive in Council under section 49(1)A of IRO to give effect to the US Agreement. The Order was published in the Gazette on 25 April 2014 and came into operation on 20 June 2014.

jurisdictions mentioned in paragraph one. The Six Orders will come into operation on 4 December 2015. The salient features of the Six Orders are summarized in the relevant Legal Service Division Report (paragraph 5 of LC Paper No. LS84/14-15) and LegCo Brief (File Ref: TsyB R 183/800-1-1/10/0 (C)).

Concerns and views expressed by Members

12. The major views and concerns on issues relating to the TIEA/AEOI regime and operation of the EoI mechanism expressed by Members at meetings of the Panel on Financial Affairs in 2009, 2012, 2013, 2014 and 2015, during the scrutiny of the Inland Revenue (Amendment) Bill 2013, 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, and the Order made under section 49(1A) of IRO and gazetted on 25 April 2014 to give effect to the US Agreement 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 Inland Revenue (Disclosure of Information) Rules (Cap. 112 sub. leg. BI) ("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, including the overriding prerequisite of meeting the standard of "foreseeable relevance"⁴, 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. Besides, the EoI mechanism also provided that any information received by a contracting party, including commercial information, should be treated confidential and might be disclosed only to persons or authorities (including courts and administrative bodies) in the jurisdiction concerned with the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes covered by the agreement; and such persons or authorities should only use such information only for such purpose. 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.

⁴ The information sought should foreseeably relevant to the administration and enforcement of domestic tax laws of the Contracting Parties, i.e. no fishing expedition.

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 about 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 taxpayers concerned.

21. In response to some Members' views that the Administration should 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 for reviewing 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/TIEA 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.

24. In response to some Member's concern on the costs in relation to handling of EoI requests, the Administration advised that the requested party shall bear the ordinary costs incurred in providing assistance for the purpose of responding to an EoI request, and the requesting party shall bear the associated extraordinary costs, if any. Examples of the extraordinary costs are fees charges by third parties for carrying out research, costs of engaging experts, interpreters or translators, litigation costs in relation to the EoI requests and costs of obtaining depositions and testimony.

Strategies for pursuing CDTAs or TIEAs and review of CDTAs

25. 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 with some jurisdictions. Even

though the Administration may conclude TIEAs with certain jurisdictions, it does not rule out the possibility of pursuing CDTAs with individual jurisdictions later if they are interested.

26. 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

27. At the House Committee meeting on 9 October 2015, Members agreed to form a subcommittee to study the Orders.

Relevant papers

28. A list of relevant papers is in the **Appendix**.

Council Business Division 1
Legislative Council Secretariat
26 October 2015

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 (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 (Page 15029-15048) 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)

Date	Event	Papers/Minutes of meeting
May 2014	The Subcommittee on Inland Revenue (Exchange of Information relating to Taxes) (United States of America) Order	Report of the Subcommittee (LC Paper No. CB(1)1601/13-14)
3 November 2014	FA Panel was briefed by the Administration on the latest development on tax transparency and the Administration's preliminary thinking on how to pursue automatic exchange of financial account information ("AEOI") in tax matters in Hong Kong	Administration's paper (LC Paper No. CB(1)122/14-15(03)) Minutes (LC Paper No. CB(1)379/14-15)
November 2014	The Subcommittee on the Two Orders Made under Sections 49 and 49(1A) of the Inland Revenue Ordinance and Gazetted on 17 October 2014	Report of the Subcommittee (LC Paper No. CB(1)290/14-15)
6 July 2015	FA Panel was briefed by the Administration on the proposed policy and legal framework on automatic exchange of financial account information in tax matters in Hong Kong	Administration's paper (LC Paper No. CB(1)1034/14-15(06)) Minutes (LC Paper No. CB(1)1258/14-15)
9 October 2015	The seven orders made under section 49(1A) of the Inland Revenue Ordinance and gazetted on 2 October 2015 was introduced into the Legislative Council	Legislative Council Briefs: Order on Kingdom of Denmark Order on Faroes Order on Greenland Order on Iceland Order on Kingdom of Norway Order on Kingdom of Sweden Order on The Mainland of China Legal Service Division Report (LC Paper No. LS84/14-15)