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By email (bc_07_12@legco.gov.hk) and by hand

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Hon Kenneth Leung
Chairman, Bills Committee on Inland Revenue (Amendment) Bill 2013
Legislative Council
1 Legislative Council Road
Central
Hong Kong

Dear Mr Leung,

Inland Revenue (Amendment) Bill 2013

The Hong Kong Institute of CPAs would like to thank the Bills Committee for the invitation to submit views on the Inland Revenue (Amendment) Bill 2013 ("the Bill").

The Institute's Taxation Faculty Executive Committee has considered the Bill, and the policy proposals explained in the Legislative Council Brief ("the Brief"), and its views are outlined below.

We support the government's successful and continuing efforts to build a network of comprehensive avoidance of double taxation agreements ("CDTAs"), as this is regarded as being essential to reinforce Hong Kong's position as an international financial centre. While these CDTAs already incorporate an exchange of information ("EoI") article, it is also understood that international expectations and norms in relation EoI are constantly changing and that Hong Kong should play its part as a respected and responsible member of the international community. There is an expectation from the international community, as represented by the Global Forum on Transparency and Exchange of Information for Tax Purposes of the Organisation for Economic Cooperation and Development ("OECD") that Hong Kong will amend the Inland Revenue Ordinance (Cap. 112, "IRO") to allow for standalone tax information exchange agreements ("TIEAs").

Notwithstanding the above, we consider that Hong Kong's existing practice of agreeing to EoI in the context of a CDTA strikes a reasonable balance between providing information to partner jurisdictions on the one hand and obtaining benefits for Hong Kong taxpayers, by way of reduced withholding taxes, etc., on the other. In many cases the preferred alternative for Hong Kong taxpayers would be the negotiation of a CDTA. In making the proposed legislative changes, therefore, it is important to ensure that there are adequate safeguards for taxpayers and that the policies of the Hong Kong SAR Government ("the Government") towards entering into CDTAs or TIEAs, and in terms of the framework for such agreements, are set out as clearly as possible for the local community.

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Policy on negotiation of tax information exchange agreements

We note that the Legislative Council Brief and the Bill do not indicate the likely framework for and typical content of a TIEA. We think that it would be helpful if such information were to be provided to the legislature in conjunction with this legislation.

We also consider that the Government should be asked to give an indication of its policy in relation to the circumstances in which Hong Kong would seek to conclude a CDTA with another jurisdiction and the circumstances in which it would consider entering into a TIEA. The Institute has previously expressed concern that once a legal framework for TIEAs is in place, Hong Kong may find it difficult to negotiate new and updated CDTAs with jurisdictions that are primarily interested in EoI with Hong Kong, which could include some major trading partners. In other words, Hong Kong's ability to enter into negotiations on CDTAs may be compromised. As pointed out in the consultation paper on the provision of a legal framework for entering into TIEAs, issued by the Financial Services and the Treasury Bureau ("FSTB") in May 2012:

“According to the OECD Global Forum whether a CDTA or TIEA is more suitable is a bilateral issue to be worked out between the two jurisdictions concerned. The principle is that one should not refuse to enter into EoI agreements (be it CDTA or TIEA) with relevant partners. It is a matter of persuasion for preference for CDTA over TIEA between the two jurisdictions concerned and if eventually the partner disagrees, then according to OECD, perference for CDTA over TIEAs cannot be a reason for refusing to enter into an EoI agreement....”

It is important, therefore, that the Government clarify how it intends to address this issue in future.

In our response to the FSTB consultatation, we suggested that, for example, consideration be given to the possibility of offering a more attractive EoI arrangement with Hong Kong through a CDTA than through a TIEA, where appropriate to do so or, if feasible, to including within a negotiation on a TIEA, an agreement to enter into a negotiation on a CDTA within a certain timeframe thereafter.

Taxpayer safeguards

We consider that recognition of taxpayers' concerns and ensuring inclusion of adequate safeguards for taxpayers under the EoI regime is an important factor in gaining community-wide support for the further development of EoI. With the introduction of legislation to allow for TIEAs, the Government is proposing to retain the existing safeguards applicable to EoI under CDTAs (paragraph 11 of the Brief). However, we are of the view that there is scope for improving the current safeguards and that this should be considered, as we explained in our response to the FSTB consultation paper.

Under the current system, the Commissioner of Inland Revenue ("CIR") is required, with some exceptions, to give prior notification of an information disclosure request

to the person in respect of whom information is requested. In this regard, Hong Kong should be seen as setting a positive example of fairness and balance. There are also safeguards in place dealing with the circumstances under which EoI can take place. The various safeguards are contained, or referred to, in (i) the Inland Revenue (Disclosure of Information) Rules, Cap. 112BI ("the Rules"), the Inland Revenue Department ("IRD")'s Departmental Interpretation Practice Notes No. 47 ("DIPN 47") or (iii) the negotiated terms of individual CDTAs, protocols concluded under section 49 of the IRO or related materials.

Rule 5 of the Rules provides for a person about whom an information disclosure request has been made to request amendment to the information to be disclosed, on the grounds that the information, or part of it, does not relate to that person or the information, or part of it, is inaccurate. Rules 6 and 7 set out the procedure for dealing with requests by a person about whom a disclosure request has been made to ask for the information to be amended. Under this arrangement a request by the person concerned can be made only to the CIR or, by way of appeal, to the Financial Secretary, with the decision of the latter being final. The Rules do not provide a taxpayer with the right of recourse to the courts or an administrative appeals tribunal. We consider that this does not provide for a fully independent appeal, and suggest that consideration be given to addressing this deficiency in the context of the current legislation, i.e. that an appeal to the court or, possibly, an administrative appeals tribunal be allowed.

Under the terms of the 2004 version of the OECD Model tax Convention EoI article, at Annex C to the Brief, it can be seen that information to be exchanged must pass the test of being “foreseeably relevant” for carrying out the agreement or administering or enforcing the tax laws of the contracting parties. As indicated at paragraph 14 (a) of the Brief, the test of being “foreseeably relevant” is retained in the 2012 version of the EoI article (which could usefully have been attached to the Brief for the purposes of comparison), and is likely to be part of any future TIEA. Under the existing article (paragraph 3(c) of Annex C), there is also no obligation to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or which is not obtainable under the laws or in the normal course of the administration of that state (paragraph 3(b)), which could, for example, include information which is subject to legal professional privilege.

However, the Rules do not allow a person about whom an information disclosure request has been made to challenge a disclosure on the grounds that the information to be disclosed is not foreseeably relevant. As in indicated in the Brief (paragraph 16), such requests may also be about a group of taxpayers.

We would suggest that, where the IRD has concurred that requested information is "foreseeably relevant", the taxpayer should be informed of the reasons for this view and safeguards should be in place to enable the taxpayer to object to a disclosure on this ground.

The Rules also do not allow a person about whom an information disclosure request has been made to challenge a disclosure on the grounds that the information concerned would disclose any trade, business, industrial, commercial

or professional secret or trade process, or that the information is subject to legal professional privilege. These omissions reflect gaps in the existing safeguards, which should be reviewed.

Other important safeguards are provided for only by references to Government policies in DIPN 47, such as the policy to limit EoI to exchange upon request only. Paragraph 17 of DIPN 47 states: "We will explain our policy in this respect to our potential treaty partners and will seek to record the matter in the CDTA, the associated Protocol, the agreed minutes or other records in writing."

Reference to certain safeguards in DIPN 47 is not sufficient, as DIPNs simply reflect IRD practice as at the time of publication and are not binding. We would suggest, therefore, that as many of the safeguards as possible, including the stipulation that information will be exchanged only upon request, be incorporated in subsidiary legislation, to provide legal authority and procedural certainty. We do not believe that this should be seen as hindering flexibility, because it is reasonable to provide an opportunity for public comment on proposals for significant changes to the framework for EoI and, in any case, subsidiary legislation can be amended relatively more easily than primary legislation.

In our response to the FSTB consultation, we also sought to clarify whether there are any specific safeguards in relation to responding to requests for information about transactions between a Hong Kong company and a related company which is located outside both Hong Kong and the requesting party's jurisdiction. In other words, whether are there, or should be, grounds for restricting the provision of information to a requesting party, insofar as it relates to a third jurisdiction. We should still like to seek clarification of the position on this matter.

EoI policies

One of the significant changes announced in the Brief is the proposed change in the Government's policy in relation to allowing information exchanged to be passed to third parties in other jurisdictions. The existing situation, which seeks to preserve confidentiality as far as possible, is explained in paragraphs 29 to 31 of DIPN 47 (under the self-explanatory headings, *Confidentiality of information exchanged*, *No disclosure to oversight authorities* and *No disclosure to third jurisdictions*). According to the Brief (paragraph 14), the proposed change in policy is in response to the 2012 version of the EoI article in the OECD Model Tax Convention and it would allow information exchanged to be passed to third parties in other jurisdictions to be used, potentially, for non-tax-related purposes.

This policy change represents a significant expansion of the existing EoI regime and one in relation to which the existing safeguards can offer only limited protection to taxpayers. It is not clear whether the intention is that Hong Kong should, in future, adopt fully the latest version of the EoI article and whether there any immediate pressure to do so. Paragraph 15 of the Brief states:

"On the use of tax information exchanged for non-tax related purposes, we are prepared to abide by OECD's new requirement by allowing our CDTA or future TIEA partners to use the information exchanged for other purposes when such

information may be used for such other purposes as specified under the laws of both sides and the competent authority of the supplying party (i.e. IRD) authorises such use. This has taken into account the fact that our domestic legislation (i.e. the Drug Trafficking (Recovery of Proceeds) Ordinance (Cap. 405), the Organized and Serious Crimes Ordinance (Cap. 455) and the United Nations (Anti-Terrorism Measures) Ordinance (Cap. 575)) already require any persons with knowledge or suspicion, including IRD officers, to disclose confidential information to authorised officers of law enforcement agencies designated under the relevant legislation to enable them to perform their duties thereunder."

We see a difference between disclosing confidential tax information to other local law enforcement authorities in order to comply with domestic legislation and assisting non-tax authorities in other jurisdictions to enforce their law.

Furthermore, it is unclear how the constraint referred to above, i.e., allowing the use the information exchanged for other purposes, when such information may be used for such other purposes under the laws of both sides, will be reflected in the context of a specific CDTA or TIEA and how it will be monitored and enforced. There is also a question mark over whether information used for non-tax purposes by the CDTA/TIEA partner could be passed on further to a third jurisdiction, if the law of the CDTA/TIEA partner allows this to happen. This is of concern because, while taxpayers may have been informed that information about them has been passed to a specific CDTA/TIEA partner of Hong Kong's, they will not be informed whether and, if so, what information about them has been passed to other authorities and for what purposes. This dilutes the effect of the original safeguard.

Should you have any questions on this submission, please contact me on 22877084 or at peter@hkicpa.org.hk.

Yours sincerely,

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PMT/EC/sc