Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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By email (tiea_consultation@fstb.gov.hk) and by hand

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Ms Shirley Kwan
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Dear Ms Kwan

Consultation on Provision of Legal Framework for Entering into Tax Information Exchange Agreements

The views of the Hong Kong Institute of CPAs (Institute) on the above consultation paper are explained below.

Overview and general comments

In the first instance, we should like to express our support for, and appreciation of, the Hong Kong SAR Government (the government)'s work and continuing efforts to build a network of comprehensive double taxation agreements (CDTAs) for Hong Kong. This is a key to reinforcing Hong Kong's position as an international financial centre.

In 2010, when the IRO was amended to allow Hong Kong to adopt the latest international standard on exchange of information (EoI) in its CDTAs, the government gave a clear message to the community. As noted by the Inland Revenue Department (IRD) in Departmental Interpretation and Practice Note No. 47 (DIPN 47), the policy of Hong Kong is to negotiate DTAs and to pursue effective EoI only within the ambit of a CDTA. Hong Kong will not enter into standalone agreements on EoI matters with other jurisdictions. This position was acceptable to the international community and Hong Kong was able to avoid being blacklisted by signing more than 12 CDTAs incorporating the latest international standard on EoI.

In 2011, the Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum) conducted a Phase 1 peer review on Hong Kong. In its report, it was acknowledged that Hong Kong has an adequate legal and regulatory framework to facilitate effective EoI. However, the report went on to recommend that Hong Kong should put in place the legal framework for entering into TIEAs.

It is appreciated that the issue of EoI is a changing landscape and that Hong Kong needs to keep abreast of standards and demonstrate that it is a responsible

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member of the international community. It is also relevant to note that the Global Forum has not expressed any concerns regarding EoI by Hong Kong in practice, although further observations may be made in Phase 2 of the peer review to be conducted later this year. Moreover, Hong Kong has a system that requires that the person in respect of whom information is requested be given prior notification of the request, which makes Hong Kong a positive example of fairness and balance for other jurdisdictions to follow. There are also safeguards in place about the circumstances under which EoI can take place and to date there has been no suggestion of any inappropriate use of EoI. At the same time, it is also recognised that the number of requests so far has been limited, as a high proportion of the CDTAs Hong Kong has entered into have only fairly recently come into effect.

However, among the important questions, which need to be asked in relation to the consultation, are whether, by providing the legal framework for entering into TIEAs with other jurisdictions, Hong Kong's ability to conclude further CDTAs will be hindered and whether even existing CDTAs may in future be terminated or not updated over time.

Furthermore, it is not entirely clear what the consequences would be were Hong Kong not to accept TIEAs. In this regard, it would be helpful if the government could elaborate further on the likely consequences of not agreeing to amend the law to allow Hong Kong to enter into TIEAs. It would also be helpful if the government would clearly re-state that its policy remains to prioritise the negotiation of CDTAs.

The safeguards currently in place under the Inland Revenue (Disclosure of Information) Rules, Cap. 112BI (the Rules) and DIPN 47, relate to CDTAs concluded under section 49 of the IRO. Were a legislative framework for TIEAs to be introduced, similar safeguards should be extended to TIEAs. We should also like to to point out that the Rules do not provide a taxpayer with the right of recourse to the courts. Under sections 6 and 7 of the Rules, a request for information to be amended can be made only to the commissioner of inland revenue, or the financial secretary, with the decision of the latter being final.

Under the terms of the model TIEA, several safeguards are provided to protect taxpayers. For instance, in Article 1, information to be exchanged is limited to information that is “foreseeably relevant” to the determination, assessment and collection of taxes, the recovery and enforcement of tax claims or the investigation or prosecution of tax matters; Article 7(2) of the model TIEA provides that there is no obligation to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process; and article 7(3) of the Model TIEA provides that information subject to legal professional privilege does not need to be disclosed. The Rules, however, do not allow a taxpayer to make a challenge on these grounds.

We believe that taxpayers should be able to have recourse to the courts or an appeals tribunal, and should also be able to challenge information disclosures about them, not merely on the basis that the information is factually incorrect, but also on the basis that it is legally privileged, would disclose a trade, business, industrial, commercial or professional secret, or trade process, or on the basis that

it is not foreseeably relevant. Accordingly, we would suggest that, if legislation for TIEAs is put forward, these gaps should be addressed.

Responses to specific questions

We now turn to the specific questions raised.

(a) Should Hong Kong proceed to work on a legal framework for TIEAs?

In our opinion this issue needs to be approached with caution. We accept that the law may, in the end, need to be amended to allow Hong Kong to enter into TIEAs and do not consider it unreasonable for Hong Kong to exchange tax information with other jurisdictions. However, the key issue for Hong Kong is that it should retain the right to choose when it enters into a TIEA and when a CDTA. That is, Hong Kong should not be forced into a situation where it is obliged to provide EoI without anything in return. We consider that Hong Kong's existing priority, of agreeing to EoI only in the context of a CDTA, strikes a reasonable balance between providing EoI to a partner jurisdiction on the one hand, and obtaining benefits for Hong Kong taxpayers by way of reduced withholding taxes, etc., on the other.

Paragraph 24 of the Consultation Paper states "… 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 TIEA cannot be a reason for refusing to enter into an EoI agreeement...."

We are concerned that, in practice, this seems to be tantamount to giving up one's bargaining position. As noted above, we consider that the government's priority should remain the conclusion of CDTAs rather than TIEAs. We would not wish to see a situation arise where Hong Kong effectively has little say in whether or not to enter into a TIEA. Rather, the government should retain the right to decide whether or not to enter into a TIEA, and certainly should not be placed in the situation where it has no choice but to enter into a TIEA, at the expense of concluding a CDTA.

(b) What are the considerations that we should take into account in choosing CDTA and TIEA partners?

In choosing CDTA partners, Hong Kong should focus on its major trading partners, both in the Asia Pacific region and elsewhere, in situations where a CDTA can help to foster international trade and investment and Hong Kong businesses and individuals can gain tangible benefits, such as favourable rates of withholding taxes on passive income. In addition, Hong Kong should look to resource-rich countries in South America and Africa, which are the focus of investment by the Mainland.

In cases where a country imposes no or minimal income taxes, consideration could be given to negotiating a TIEA. However, generally speaking and having regard to Hong Kong's territorial basis of taxation, we do not envisage an overriding need for Hong Kong to obtain information from other jurisdictions.

(c) Do you have any other suggestions on the implementation of the CDTA and TIEA programmes?

If provision to enter into TIEAs is introduced into the law, as indicated above, the safeguards that exist in relation to EoI under CDTAs should be extended to TIEAs. As also explained above, there is case for expanding the framework of safeguards to allow taxpayers to be able to take their appeal to the courts or an appeals tribunal and to be able challenge an information exchange on the basis that the information is legally privileged, would disclose a trade, business, industrial, commercial or professional secret, or trade process, or is not foreseeably relevant.

We should also like to clarify whether there are any specific safeguards in relation to responding to requests for information relating to the transfer pricing or other transactions between a Hong Kong company and a related company which is located outside of Hong Kong and the requesting party's jurisdiction. In other words, are there, or should there be, restrictions on the provision of information to a requesting party, insofar as it relates to a third party jurisdiction?

While noting that tax examination abroad in Article 6 is not a mandatory provision, the Institute considers that this should not be an agreed provision in any TIEA and that this exclusion should be made clear in the legal framework.

(d) What are the specific concerns for not supporting the legal framework for TIEA?

If Hong Kong amends the law to allow it to enter into TIEAs, the concern is that we may be placed in a position where it is not possible to refuse any request by another jurisdiction for a TIEA, regardless of whether Hong Kong has a stated policy for generally preferring CDTAs over TIEAs with other jurisdictions. On the face of it, this would place Hong Kong at a disadvantage in its future efforts to negotiate CDTAs with jurisdictions with which it has already signed a TIEA. The concern is that once a jurisdiction, for example, the United States, has entered into a TIEA with Hong Kong, there may be little incentive for that jurisdiction to subsequently conclude a CDTA with Hong Kong. From that jurisdiction's perspective, the principal driver for negotiating a CDTA with Hong Kong may be the EoI clause, so if it has entered into a TIEA with Hong Kong, it would already have access to EoI, thus obviating the need for a CDTA.

(e) Are there any possible ways to address these concerns?

Hong Kong should retain the right to determine whether, for a particular jurisdiction, it will negotiate a CDTA or a TIEA, albeit this may deviate from the Global Forum's position that jurisdictions should not refuse a request from another jurisdiction for EoI, where that jurisdiction is not willing to negotiate a CDTA.

If, after a full assessment, it is deemed that the consequences of deviating from the Global Forum's above position would be too detrimental to Hong Kong's interests, consideration could be given to the feasibility of Hong Kong's adopting either or both of the following approaches:

(i) Providing a template for TIEAs which is less extensive in scope than the standard EoI article in Hong Kong's CDTAs. This would provide a practical incentive for other jurisdictions to negotiate a CDTA, if they wished to have a more extensive EoI arrangement with Hong Kong.

(ii) Making it a pre-condition for entering into a TIEA that the other party agrees to enter into negotiations on a CDTA within a certain timeframe thereafter.

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

Yours sincerely,

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