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16 October 2001

Mr. Tam Kuen-chong,
Deputy Commissioner of Inland Revenue,
Inland Revenue Department,
36/F, Revenue Tower,
5 Gloucester Road,
Wanchai, Hong Kong.

Dear Mr. Tam,

Consultation on “Exchange of Information” for Tax Treaty Purposes

Thank you for inviting the Society’s comments on the Consultation Paper on “the ‘Exchange of Information’ article to be considered in a comprehensive double taxation agreement [“DTA”] between Hong Kong and other countries” (“the Paper”).

We fully agree with the position stated at paragraph 15 of the Paper on the need for careful consultation and consideration in relation to any proposals for relaxation of the strict confidentiality provisions contained in section 4 of the Inland Revenue Ordinance (Cap. 112) (“IRO”). We believe that the protection offered by s4, IRO has in the past benefited Hong Kong economically and the enforcement of such provisions is one facet of the rule of law in Hong Kong which as a whole is critical to our future stability and prosperity. This being the case, if Hong Kong is to move away from its long-established position in relation to the confidentiality of tax-related information (subject to the few existing exceptions) then we need to be very clear about what concrete benefits would accrue in return. Conversely, if any supposed disbenefits would result from maintaining the status quo, then we need to be sure that these are real and material and would arise directly as a result of any decision not to modify the existing position.

However, we believe that the Paper reflects some uncertainty on these important issues. While the focus is initially upon a possible exchange of information article in DTAs with other jurisdictions, it is subsequently noted in paragraph 8, that the response of other countries, particularly OECD members, towards negotiating DTAs with Hong Kong has not been enthusiastic. It is not clear that this is due to concerns over the extent of any exchange of information article rather than other factors, such as the nature of Hong Kong’s low tax regime which may reduce the perceived benefits of such an agreement to jurisdictions that tax more highly.

This apparent lack of enthusiasm by our trading partners for DTAs may explain why the Paper then proceeds to discuss what is referred to as “a global trend for countries to enter into stand-alone agreements on exchange of information”. However, in relation to this issue, we have reservations over the considerable weight given to the position put forward by the OECD on harmful tax practices. This part of the Paper seeks to draw attention to the possible disadvantages to Hong Kong of not moving towards a more “liberal” exchange of information regime. However, other than a general indication that a failure to follow this direction could lead to Hong Kong being blacklisted, no specific reasons are provided to suggest any advantage to Hong Kong of reducing the secrecy provisions contained in s4, IRO. We believe, in any case, that this particular concern may have been over-stated, especially in light of current developments regarding the OECD initiative on tax havens to which we refer below.



Although Hong Kong is not on the list of tax havens in the OECD's 2000 progress report, the Paper points out that certain jurisdictions, including Italy, Poland, Ukraine and Venezuela, have unilaterally placed us on their own lists of tax havens or low-tax jurisdictions. Hong Kong has of course always regarded being a low-tax regime as a virtue not a vice, hence the incorporation of this principle into the Basic Law. We would question therefore any arbitrary categorisation of Hong Kong by a limited number of other jurisdictions, whose importance to Hong Kong in any event may not be that great. However, insofar as this type of pigeonholing carries negative connotations or has any adverse practical consequences, perhaps it would be more appropriate for us to challenge the basis for their taking unilateral action, which could arguably amount to a form disguised of protectionism on their part. In this respect, we are pleased to have heard that the Commissioner of Inland Revenue reiterated Hong Kong's position at a recent conference held in Paris.

As regards the OECD initiative on tax havens, we would point out that backing for this is far from unequivocal and, in this context, would refer you to the widely-publicised withdrawal of support for elements of the initiative by the Bush Administration in the United States, as set out in a statement tabled by US Treasury Secretary O'Neill on 10 May 2001. This withdrawal of support has led to several important developments in the OECD initiative and the prospect of sanctions being imposed on offshore centres has receded with any such measure being delayed until at least 2003. While the events in New York of 11 September 2001 may ultimately affect this position, it is too soon at this stage to draw any conclusions.

Under the circumstances, we believe that the threat may not be as immediate or real as it might at first appear and, therefore, that we have more time to consider all the implications before deciding how we can best act to protect Hong Kong's long-term interests. If we proceed unilaterally or proactively at this stage, then, apart from any other implications, there would be potential consequences for the Arrangement between the Mainland and the Hong Kong SAR for the Avoidance of Double Taxation on Income, which would be of some concern to many Hong Kong residents.

While we appreciate the need for Hong Kong to be aware of international developments in terms of regulation, in this case tax regulation, for the reasons indicated above, the Society would oppose acceptance of the article on exchange of information contained in the OECD Model Convention issued in 2000, despite the suggestion in the Paper that this may generally become the starting point for newly commenced negotiations on DTAs. Our concerns about the position reflected in the Paper therefore may be summed up in the following terms:

- (a) It concentrates too much on the potential threat to Hong Kong if we do not fall into line with what is perceived to be an international trend spearheaded by the OECD. However, as explained above, we believe that the perceived threat has been over-stated, as e.g. it does not take account of the Bush Administration's position in this matter and changes already made or being made to the initiative;
- (b) it does not refer to the fact that other jurisdictions, including OECD members Switzerland and Luxembourg, continue to resist pressure to exchange information for tax enforcement purposes. In particular, these "non-co-operating" OECD states are the principal onshore competitors for the offshore centres, including Hong Kong. There is a significant risk, therefore, that if Switzerland and Luxembourg are not obliged to adhere to the standards that the OECD seeks to impose on offshore centres, business will migrate from the latter to the former. Under these circumstances, the surrender of the secrecy provisions in s4 IRO will significantly affect Hong Kong's ability to

compete with these countries with no appreciable benefits accruing to Hong Kong in return;

- (c) more account needs to be taken of the unique aspects of Hong Kong's tax system, including our commitment to maintaining a low tax regime, and generally the differences between Hong Kong and other tax jurisdictions and the implications of these for the exchange of information;
- (d) following on from the above, there is a need to analyse more fully the benefits or otherwise of our entering into DTAs, and to assess the increased likelihood of Hong Kong being able to conclude DTAs with, e.g. the United States, the United Kingdom, etc., if a more liberal exchange of information article is agreed;
- (e) the possible implications of this whole issue for the Mainland – Kong Kong double taxation arrangements need to be considered further; and
- (f) generally, an assessment should be made of the possible disadvantages to Hong Kong of adopting a liberal exchange of information regime.

We would suggest that if a consensus were to be reached that it would be beneficial for Hong Kong to conclude a DTA, then we ought to approach the negotiation by arguing for the most conservative exchange of information clause rather than adopting a more liberal approach to this important issue.

In conclusion, the Society believes that the confidentiality provisions of s4, IRO have up until now been a positive advantage to Hong Kong's economic development and a plus point for potential investors. We believe that they should not be given up or further diluted without very good cause and without the reasonable expectation of fairly specific benefits accruing to Hong Kong in return. Finally, we doubt the need to expedite action on this issue and would suggest that we continue to resist any external pressure that there may be to precipitate decisions that could have major repercussions for Hong Kong's future economic wellbeing.

Yours sincerely,



PETER TISMAN
DEPUTY DIRECTOR
(BUSINESS & PRACTICE)
HONG KONG SOCIETY OF ACCOUNTANTS

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