



The Revenue Law Committee of the Law Society of Hong Kong

Position Paper

on

The Potential Liberalization of the Exchange of Information Article to be Included in Hong Kong's Double Tax Agreements

An agreement between two jurisdictions for the avoidance of double taxation (a DTA) reduces fiscal friction between them and promotes trade and investment by stipulating what activities will constitute a taxable presence (or permanent establishment), how capital gains and income earned by a resident of one side are taxed by the other side, how to determine whether an individual or entity is resident of one side or the other, how to resolve disputes over taxing rights, as well as reducing withholding taxes. Compared with tax relief granted unilaterally under domestic law, the relief under a DTA is more comprehensive, favorable and certain. Hong Kong now has three DTAs, with the Mainland, Thailand and Belgium. These DTAs are based on the model tax convention on income and capital developed by the OECD. The Committee supports efforts to conclude a broad network of DTAs in order to further enhance Hong Kong's position as an international business and financial centre.

Each DTA contains an article allowing the tax authorities of one side to request tax information from the authorities of the other side (an exchange of information article, or EoI). Hong Kong's existing DTAs adopt the form of EoI found in the OECD's 1995 model DTA, which allows our DTA partners to request tax information ordinarily collected by the Inland Revenue Department (IRD). The IRD can refuse to collect and supply information requested by the other tax authority where the IRD does not collect the information for its own purposes. Over the intervening years the OECD has refined its DTA, and it issued a revised version in 2004 containing a revised EoI (the 2004 EoI) providing for a broader exchange of information. Pursuant to the 2004 EoI, one side cannot refuse to collect and supply tax information requested by the other side because that side does not collect the information for its own purposes (i.e. – lack of a domestic tax interest in the information sought does not constitute grounds for refusing the information request). Most countries require this form of EoI to be included in any new DTA they negotiate. However the IRD is not empowered to collect information unrelated to Hong Kong taxes. As a result, the Hong Kong government is unable to conclude DTAs with most of our major trading partners. If it is decided to move to the 2004 EoI, Hong Kong's legislation (including the Inland Revenue Ordinance) must be amended to authorize the collection of tax information relevant to requests received from its DTA partners.

Apart from this legal disability Hong Kong, with its tradition of confidentiality in relation to financial matters, has been understandably reluctant to agree unrestricted exchange of tax information. However, Hong Kong is also pragmatic, and realizes that the goal of confidentiality must be balanced with potential gains from being able to enter into DTAs with our major trading partners, most of whom view the exchange of tax information as a matter of high importance. If Hong Kong had a web of DTAs with these countries, its position as an international business and financial center would be substantially enhanced, it would bring Hong Kong into step with the OECD countries, and it would prevent those DTA partners from taking “defensive measures” against Hong Kong. Some countries view Hong Kong’s refusal to share tax information and low rates of tax suspiciously, and are considering including Hong Kong on a list of countries against which “defensive measures” (consisting mostly of tax measures which make it uneconomical for their residents to do business or invest in Hong Kong) may be taken. Concluding DTAs with such countries incorporating the 2004 EoI would avoid these consequences.

Several concerns have been expressed about the 2004 EoI. One concern is that a DTA partner may ask for non-tax information. The IRD would reject such a request, since the 2004 EoI is limited solely to “information concerning taxes”. Moreover the information exchange standards agreed by the OECD members prohibit so-called “fishing expeditions”. Some are concerned that the 2004 EoI would somehow impose an obligation on the IRD to collect taxes owed to our DTA partners. The 2004 EoI does not require nor empower one side to collect the tax debts of another. There is also a concern that the information collected under the EoI may be divulged to a third party. Again, the information exchange standards agreed by the OECD members prohibit disclosure of information obtained from one side to a third party. The information obtained must be kept confidential and is only to be used by tax authorities or tax supervisory bodies. And last, but not least, some members have expressed concerns that the drafting of the 2004 EoI is confusing and lacks the precision desirable for tax legislation.

Clearly the international community is moving towards more and more extensive disclosure of tax information. If Hong Kong remains unable to agree the 2004 EoI, it risks international marginalization. In the view of the Committee, the benefits of having a network of DTAs outweighs the benefits of confidentiality and the difficulty of amending Hong Kong’s legislation to permit the IRD to collect tax related information necessary pursuant to the provisions of the 2004 EoI. However, this endorsement is not unreserved. If the Hong Kong Government decides to take the necessary steps under law to enable it to agree the 2004 EoI, we would recommend that:

- When concluding any DTA incorporating the 2004 EoI, it obtain undertakings from the other side that
 - Its requests under the 2004 EoI will be limited to tax information only
 - The information it receives from Hong Kong under the 2004 EoI will not be divulged to third parties
- As a *quid pro quo* for agreeing the incorporation of the 2004 EoI in any DTAs, Hong Kong must be removed from any fiscal disability or “blacklist” maintained by the other side

- Hong Kong should avoid entering into standalone EoI agreements. The 2004 EoI should be used as a lever to obtain concessions, in the form of a DTA, from the other side.

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