
Feeling the Heat: Will Hong Kong Succumb to International Pressure for Enhanced Transparency, Cooperation and Information Exchange on Taxation Matters?

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FEELING THE HEAT: WILL HONG KONG SUCCUMB TO INTERNATIONAL PRESSURE FOR ENHANCED TRANSPARENCY, COOPERATION AND INFORMATION EXCHANGE ON TAXATION MATTERS?

Adrian Sawyer*

Abstract

Internationally the pressure on nations perceived to be uncooperative and lacking in transparency in the operation of their taxation systems is intensifying. International organisations, such as the OECD and the EU, are riding the wave of enhanced cross-border information flows, growing ever more confident when nations such as Switzerland, Singapore and numerous tax havens worldwide, agree to commit to enhanced transparency. Momentum is also gathering pace as nations clamber to negotiate an intergovernmental agreement with the United States under its much criticised Foreign Account Tax Compliance Act (FATCA). The Hong Kong Special Administrative Region (HKSAR) is not immune from feeling this pressure, and appears to be relenting, in part at least, through the recent gazetting of the Inland Revenue (Amendment) Bill 2013 which would enable enhanced information exchange under comprehensive double tax agreements (DTAs) and the entering into of tax information exchange agreements (TIEAs). This paper outlines the implications of these international developments and examines HKSAR's responses to date. Predictions for what the future may hold for HKSAR will be contemplated.

1.0 Introduction and Background

Internationally the pressure on nations perceived to be uncooperative and lacking in transparency in the operation of their taxation systems is intensifying. International organisations, such as the Organisation for Economic Cooperation and Development (OECD) and the European Union (EU), are riding the wave of enhanced cross-border information flows, growing ever more confident when nations such as Switzerland, Singapore and numerous tax havens worldwide, agree to commit to enhanced transparency. Momentum is also gathering pace as nations clamber to negotiate an intergovernmental agreement with the United States (US) under its much criticised Foreign Account

* Dr Adrian Sawyer is Professor of Taxation, and former Acting Pro-Vice-Chancellor and Dean, College of Business and Economics, University of Canterbury, Private Bag 4800, Christchurch NZ. Email: adrian.sawyer@canterbury.ac.nz. The discussion in this paper draws upon other research that the author is working on with respect to the various international tax developments that are analysed. I am grateful in particular to Professor Richard Cullen and staff associated with the Asian Institute of International Financial Law and Taxation Law Research Programme at the University of Hong Kong for enabling me to develop and present this paper, and to my colleague Associate Professor Andrew Maples for his comments on an earlier version of this paper. This is a revised version of a paper presented at the University of Hong Kong and the Hong Kong Institute of Certified Public Accountants. Any remaining errors are mine. This paper sets out the state of play as at 30 June 2013.

Tax Compliance Act (FATCA).¹ The Hong Kong Special Administrative Region (HKSAR) is not immune from feeling this pressure, and appears to be relenting, in part at least, through the recent gazetting of the Inland Revenue (Amendment) Bill 2013 (the Bill) which would enable enhanced information exchange under comprehensive double tax agreements (DTAs) and the entering into of tax information exchange agreements (TIEAs).

Specifically this paper utilises document analysis and a review of the emerging literature and commentary to assess the potential impact of these major developments in international taxation from the perspective of the HKSAR. It is policy focussed and takes a critical realist perspective with respect to both the ‘global’ initiatives reviewed and the possible approach that the HKSAR will take. While there has been growing debate in the literature over the OECD’s exchange of information (EOI) requirements and the US’s FATCA, the discussion in the HKSAR to date has been limited. This includes opinions in the popular press, and the emerging legislative amendment (via the Bill) with respect to enabling the HKSAR to enter into TIEAs and widening the scope of EOI under the HKSAR’s existing DTA program. This provides the motivation for the paper. The HKSAR is a major financial centre, which has traditionally resisted EOI other than to facilitating the minimal level possible under OECD recommendations, while striving to protect the privacy of financial information on behalf of its citizens and investors. Currently the HKSAR is facing unprecedented pressure from the OECD and the US with respect to limited ability to be involved in EOI, and potentially to become more transparent and cooperative globally with respect to EOI. The influence of the People’s Republic of China (China) is a further complicating factor in terms of whether the HKSAR will follow China’s lead, or be able to chart its own path through the potentially ‘treacherous waters’ of international taxation overseen by global players such as the OECD and the US.

The remainder of this paper is as follows. The next section provides a brief overview of recent international developments to set the scene for the major discussion in this paper, in section 3, namely the impact on the HKSAR of OECD and US developments, reflected in part by legislative proposals currently before the HKSAR’s Legislative Council (LegCo). After analysing the implications of these international developments and examining HKSAR’s responses to date in section 4, the paper concludes in section five, and incorporates some predictions for what the future may hold for HKSAR, as well as leaving many unanswered questions.

¹ Pub. L. No. 111-147, 124 Stat 71 (March 18, 2010). FATCA comprises sections 1471 to 1474 of the Internal Revenue Code 1986.

2.0 An Overview of International Developments

Following the Global Financial Crisis (GFC), the pressure from governments to collect outstanding taxes, especially those from residents' offshore bank accounts, has risen dramatically. Initiatives include further efforts by the OECD to encourage expansion of the Global Forum on Tax Administration (Global Forum)² while concurrently expanding the network of TIEAs and bilateral DTAs. A notable feature of this new emerging environment of enhanced regulation is a series of globally reaching initiatives designed to facilitate the efforts of revenue authorities to collect outstanding taxes.

Contributions on the subject of greater cooperation in taxation across borders are extensive, whether it is at the governmental level or by revenue authorities.³ It is not the aim of this paper to traverse this literature other than to highlight several recent contributions. In terms of the state of "global tax governance", Wouters and Meuwissen⁴ examine the state of play concerning moves in the area of greater governance of tax policy and practice from a global perspective. With the aftermath of the GFC, international initiatives concerning tax governance have gained political momentum. The authors examine the roles and work of the G20, OECD, United Nations (UN), International Monetary Fund (IMF) and the World Trade Organisation (WTO). The authors suggest⁵ that the OECD has engaged in a symbiotic relationship with the G20, with the IMF's input less effective. While arguably the UN is a truly global actor, it lacks institutional capabilities in the area of taxation, and thus relies on other actors in this regard (such as the OECD). International cooperation is now the norm with respect to exchange of information and fiscal transparency.

² The Global Forum emerged from work of the OECD in the early 2000s to address the risks to tax compliance posed by tax havens. The original members of the Global Forum consisted of OECD countries and jurisdictions that had agreed to implement transparency and exchange of information for tax purposes. The Global Forum was then restructured in September 2009 in response to the G20 call to strengthen implementation of these standards. The Global Forum currently has 120 members, and is focusing on the implementation of the internationally agreed standards of transparency and EOI in the tax area. It undertakes a peer review process of its members, and monitors whether its members fully implement the standard of transparency and EOI that they have committed to implement. See further <http://www.oecd.org/tax/transparency/>.

³ For further discussion, see the forthcoming works by the author: Adrian Sawyer, "Assessing the Implications of the Multilateral Convention of Mutual Administrative Assistance in Tax Matters and the Foreign Account Tax Compliance Act: An Australasian Perspective", *Paper for the Tax Research Network Conference*, University of Exeter, September 2-4 (2013); and Adrian Sawyer, "Comparing the United Kingdom-Switzerland Tax Cooperation Agreement with the United Kingdom's and Switzerland's Intergovernmental Agreements with the United States under the Foreign Account Tax Compliance Act", *Paper presented at the Society of Legal Scholars Conference, Faculty of Law*, University of Edinburgh, 5-6 September 2013.

⁴ Jan Wouters and Katrien Meusissen, "Global Tax Governance: Work in Progress?" (2011) *Leuven Centre for Global Governance Studies*, Working Paper No 59.

⁵ Ibid, 29.

While there have been numerous calls for some form of World (or International) Tax Organisation to undertake such a coordinating role, to date there is little in the way of tangible progress.⁶ The IMF in 2010 revised the idea of a World Tax Organisation as a way of energising the fight against tax evasion and avoidance.⁷

In relation to the TIEA initiative, Soriano suggests that there appears to be little future for the TIEA unless it undergoes radical reform.⁸ This is largely due to the OECD and Global Forum focusing on the quantity of TIEAs and less on the ‘quality’ of the signatories.⁹ The OECD and Global Forum have yet to formally review the standard under the TIEA model and how traditionally “uncooperative” tax havens are acting under these TIEAs.¹⁰ The OECD frequently promotes the TIEA model as the international standard of ineffective transparency and collaboration.¹¹ As Soriano observes¹²:

“... a TIEA is a tool that allows banking havens to make a *show of cooperation* while *continuing with their essential business of selling tax evasion services to residents of rich countries*. It is a contract which cannot function if there has been no meeting of the minds, and it is *not an efficient way to address information sharing*, insofar as it cannot force domestic actors to do what they have no interest in doing. It also does not specify what is to be done if there are no appropriate domestic legal provisions to collect the information: there is no obligation to create new or quicker mechanisms to access information contained in the TIEA model.”

⁶ See for example: Vito Tanzi, ‘Is there a Need for a World Tax Organisation?’, in Assaf Razin and Efraim Saka (eds), *The Economics of Globalisation: Policy Perspectives from Public Economics* (Cambridge University Press, 1999), 173-186; Dale Pinto, ‘A Proposal to Create a World Tax Organisation’ (2003) 9(2) *New Zealand Journal of Taxation Law and Policy* 145-160; Adrian J Sawyer, *Developing a World Tax Organisation: The Way Forward* (Fiscal Publications, 2009); Dale Pinto and Adrian Sawyer, ‘Towards Sustaining the Future of Taxation: Is a World Tax Organisation Necessary and Feasible in Today’s Globalized World?’ (2009) 24(2) *Australian Tax Forum*, 179-205; and Dale Pinto and Adrian Sawyer, “Building Bridges Between Revenue Authorities: Would a World Tax Organisation Be a Key Facilitator?” (2011) *Journal of Applied Law and Policy*, 25-40.

⁷ Carlo Cotarelli and Andrea Schaechter, *Long-Term Trends in Public Finances in the G-7 Economies*, IMF Staff position note, SPN/10/13, 21 (Sept. 2010), <http://www.imf.org/external/pubs/ft/spn/2010/spn1013.pdf>.

⁸ Alberto Gil Soriano, “Toward an Automatic but Asymmetric Exchange of Tax Information: the US Foreign Account Tax Compliance Act (FATCA) as Inflection Point” (2012) 40(1) *Intertax* 540-555, 553.

⁹ See Adrian Sawyer, “Peer Review of Tax Information Exchange Agreements: Is it *More* than just about the Numbers?”, (2011) 26(3) *Australian Tax Forum*, 397-427.

¹⁰ *Ibid*, 542.

¹¹ *Ibid*, 543.

¹² *Ibid*, 543 (references omitted and emphasis added).

Elsewhere I have written and conclude with respect to the TIEA initiative¹³:

“The initial focus of Global Forum was a ‘numbers game’, illustrated by the total number of TIEAs, plus a minimum of 12 agreements per ‘blacklist’ jurisdiction. To be fair, there is now some qualitative analysis emerging with the Peer Review process and the release of their country reports.

TIEA ‘effectiveness’ is seriously in question. While there is a regulatory process in place this does not necessarily guarantee effective information exchange. ... the TIEA initiative will need to undergo major revision if it is to have any realistic chance of making effective inroads to information exchange. Systematic change to the Model TIEA ... appears to be most unlikely. This leaves the question open as to whether the TIEA initiative is an expensive exercise in ‘window dressing’ that leaves tax havens with little to fear and other countries with little to gain.”

In terms of EOI, over the last few years, it is clear that with taxpayers operating on a global basis, tax authorities have looked to move from bilateral to multilateral forms of cooperation, and from exchange of information on request to other closer forms of cooperation, such as spontaneous exchange of information sharing. Much of the impetus for this has been at the behest of the OECD.

However, it is important to ask the question, “Why is information exchanged?” According to the OECD, information is typically exchanged for one of two purposes. The first is that information is exchanged in order to ascertain the facts in relation to which the rules of an income tax convention are to be applied. The second reason is that information is exchanged with a view to assisting one of the contracting parties in administering or enforcing its domestic tax law.¹⁴ The main form of EOI is exchange of information on request, which refers to a situation where the competent authority of one country asks for particular information from the competent authority of another contracting party. Information may also be exchanged, if permitted by an agreement, automatically or spontaneously.

In terms of the recent position of the OECD, on 19 April 2013 OECD Secretary-General Angel Gurría indicated:¹⁵

¹³ Adrian Sawyer, “The OECD’s Tax Information Exchange Agreements: An example of (in)effective global governance?” (2011) *Journal of Applied Law and Policy* 41-54, 54 (emphasis added). With commentators arguing that the TIEA mechanism is ‘ineffective’, this raises the question of why the OECD (and the Global Forum) is still ‘promoting’ it. In part their focus on “quantity” would appear to be partly to blame for the ineffectiveness of TIEAs.

¹⁴ OECD, Manual on Information Exchange (OECD, Paris, 2006).

¹⁵ OECD (Centre for Tax Policy and Administration), OECD reports new developments in tax information exchange (April 2013), emphasis added.

“The political support for automatic exchange of information on investment income has never been greater. Luxembourg has changed its position and the US FATCA legislation is *triggering rapid acceptance of automatic exchange* and propelling European countries to adopt this approach amongst themselves. In response to the G20 mandate to make automatic exchange of information the new standard, the *OECD is developing a standardised, secure and effective system of automatic exchange.*”

The Secretary General also indicated that the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (Multilateral Convention) is seen as the ideal legal instrument for multilateralising automatic exchange of information.¹⁶ To this end, it is considered to provide governments with a variety of means to fight offshore tax evasion and ensure compliance with national tax laws, while *respecting the rights of taxpayers*.¹⁷ Just where the balance should be between Governments receiving sufficient information to enable them to accurately assess taxation liabilities on their residents and those with accounts in their jurisdictions, and to protect taxpayers rights to privacy and choice, is one of immense importance to the debate over EOI. This paper will now consider this emerging debate in the context of recent developments in the HKSAR.

3.0 The Inland Revenue (Amendment) Bill 2013 and the Foreign Account Tax Compliance Act

3.1 *Proposals to enhance exchange of information – the amendment Bill*

The HKSAR has for some time been actively pursuing an agenda of greater cooperation with respect to tax administration with other jurisdictions through entering into DTAs. Elsewhere¹⁸ I have reviewed the new approach to negotiating DTAs, suggesting it is a response to the new environment emerging from greater globalisation, buttressed by the growing pressure from the OECD to promote enhanced transparency and information exchange. Since the 2010 legislative enactment empowering the HKSAR Inland Revenue Department (IRD) to obtain information requested by a DTA partner through a DTA,¹⁹ the number of DTAs concluded by the HKSAR with other jurisdictions has grown rapidly to be approaching 30 agreements from only a handful prior to the amendment. Of interest to

¹⁶ OECD, *Multilateral Convention for Mutual Assistance in Tax Matters* (1988), as amended in 2011 (CETS 127). See also the Council of Europe’s (CoE’s) *Explanatory Report on the Multilateral Convention* (2011)

¹⁷ Ibid (my emphasis).

¹⁸ Adrian Sawyer, ‘The Hong Kong Special Administrative Region’s Emerging Double Tax Agreement Regime: A Case Study of the Hong Kong Special Administrative Region-New Zealand DTA’, (2011) 41(3) *Hong Kong Law Journal*, 659-676. See also Adrian Sawyer, ‘Practitioners’ Corner: Highlights of the Hong Kong-New Zealand DTA’ (2011) 61 *Tax Notes International* (January 31), 377-380.

¹⁹ Inland Revenue Ordinance (Cap. 112) (IRO).

note is that a number of these DTAs would in all probably be a TIEA if the negotiating jurisdiction was, for example, a member of the OECD.²⁰

This drive by the HKSAR to negotiate DTAs appears to be driven by factors other than whether the HKSAR's Government (and more importantly, the IRD), has a domestic tax interest in the information that may be exchanged via the DTA. Certainly the HKSAR is not concerned about any double taxation, given its narrow tax base (profits tax, salaries tax and property tax) that is territorially based, with no residence-based taxation that is common to most OECD jurisdictions. Why this approach? It is arguable that this legislative amendment that facilitated DTAs is attributable to pressure from the OECD on the HKSAR to become more cooperative and move off the OECD's blacklist. Regardless of the motive, the international pressure was such that the HKSAR amended its EOI legislation and it has pledged to include strengthened EOI provisions in its future DTAs. This promise is now moving into the spotlight with the current Bill before LegCo.

Thus the pressure on the HKSAR has not ceased through pursuing its DTA programme. During the latter part of 2012 and into 2013, pressure from the OECD has been mounting on jurisdictions, including the HKSAR, to expand their EOI capability to the latest OECD standard, plus to enable TIEAs to be negotiated with other jurisdictions.²¹ The TIEA is based on a more expansive EOI facility developed by the OECD and being progressively 'encouraged' via the Global Forum and its on-going Peer Reviews.²²

The Global Forum has recommended that the HKSAR should put in place a legal framework for entering into TIEAs, thereby enabling it to catch up with the prevailing international standard for EOI under TIEAs. Consequently, on 12 April 2013, the Inland Revenue (Amendment) Bill 2013 (the Bill) was gazetted. The Bill aims to enable the HKSAR to enter into TIEAs with other jurisdictions where necessary, and to enhance the existing EOI arrangements under comprehensive DTAs.²³

²⁰ This includes the HKSAR's DTA with Guernsey, Jersey and Liechtenstein.

²¹ Prior to the proposed new ordinance, under the Inland Revenue Ordinance (Cap. 112) (IRO), the HKSAR could only exchange tax information with another jurisdiction under the framework of a comprehensive DTA that the HKSAR has entered into with that other jurisdiction. Notwithstanding the views of some commentators that the TIEAs have not been hugely successful, the OECD (and the Global Forum) remains committed to this approach and hence the expectation of Global Forum members to meet the EOI requirements and be able to enter into TIEAs.

²² The HKSAR is one of the current 120 members of the Global Forum. For further discussion on TIEAs, see section 2 of this paper. Further analysis of the role and potential 'teeth' behind the Peer Reviews is provided by the author; see Sawyer, above n 13.

²³ It is important to note that TIEAs provide for EOI without double taxation relief, whereas the existing Ordinance only permits the HKSAR to enter into a tax agreement where there is double taxation relief, and with a version of EOI that is less comprehensive than the OECD's current standard.

The HKSAR's Commissioner of Inland Revenue (Commissioner) commented on 2 May 2013, in relation to the Bill, that:²⁴

“In recent years, there have been increasing aspirations to enhance tax transparency with a view to preventing and combating fiscal evasion. According to the latest international standard, a jurisdiction should be able to enter into 2 types of information exchange instruments. The first one is the CDTAs which Hong Kong has been promoting. The second type is the Tax Information Exchange Agreements (TIEAs). *It is thus time critical for Hong Kong to have in place a legal framework for TIEAs so as to comply with the international standard, thus preserving Hong Kong's international reputation, and avoiding Hong Kong being regarded as an uncooperative tax jurisdiction.* Towards this end, the Government introduced the Inland Revenue (Amendment) Bill 2013 into the Legislative Council last week.”

Notwithstanding this comment, an attempt was made to demonstrate that the HKSAR was not “rolling over” to the pressure. An Inland Revenue spokesperson has stated:²⁵

“[T]he Government will continue to adopt the existing highly prudent safeguards to protect taxpayers' privacy and confidentiality of information exchanged under both CDTAs and future TIEAs. Same as the current approach for CDTAs, the Government will strive to include the safeguards in the texts of the future TIEAs, which will be implemented as subsidiary legislation domestically subject to negative vetting by the Legislative Council. The applicability of the Inland Revenue (Disclosure of Information) Rules (Cap. 112BI), which are currently applicable to EOI under CDTAs, will also be extended to TIEAs signed in future.”

The changes the Bill proposes to make, on their face, appear to be relatively minor amendments to enable this expansive power to enter into TIEAs.²⁶ Nevertheless, the minor wording changes have significant ramifications, something that has not been lost in the discussion accompanying the Bill. The Legislative Council Brief to the Bill highlights that a major driver for this initiative is that the HKSAR had its Phase 1 Peer Review Report (the Report) by the Global Forum completed in October

²⁴ See http://www.ird.gov.hk/eng/pdf/2013_cir_speech_e.pdf (emphasis added).

²⁵ See Press Release; Inland Revenue (Amendment) Bill 2013 gazetted”; available at <http://www.ird.gov.hk/eng/ppr/archives/13041201.htm> (emphasis added).

²⁶ The Bill is only five pages in length with a two page explanatory memorandum. While it may appear to be small and rather innocuous, the implications of the proposed amendments are significant and potentially erode the HKSAR's approach to privacy of information and reluctance to engage in EOI with other jurisdictions.

2011.²⁷ This Report, while endorsing the HKSAR's efforts for enhancing transparency, emphasized that there was need for a framework to allow for TIEAs in addition to incorporating the latest EOI standard within its DTAs. The Phase 2 Peer Review commenced in December 2012. In order to pass this review, the HKSAR would need to have a framework in place to enable TIEAs and an expanded EOI for DTAs, ideally by mid-2013, with the Phase 2 Report due to be completed by September 2013. Emphasis was placed on the fear of the HKSAR being labeled an 'uncooperative jurisdiction', which was seen as "... highly undesirable for Hong Kong's international reputation, and may in turn undermine our position and competitiveness as an international business and financial centre."²⁸ Unilateral sanctions imposed by other jurisdictions were also seen as a potential risk.

Added to this pressure, the HKSAR was experiencing a reluctance from some jurisdictions to conclude a DTA with it, as these jurisdictions were reportedly unconvinced of the case for pursuing a DTA and therefore 'holding out' to see what would eventuate. Adopting the approach in the Bill is seen as going some way to overcoming this reluctance to enter into tax agreements with the HKSAR. While desiring to retain confidentiality and privacy of information exchanged, there appears to be a 'resignation' to the necessity of abiding by the OECD's expanded requirements for EOI, including its use for a broader range of purposes, as will need to be specified under the laws of both jurisdictions to any agreement. In its analysis, the Financial Services and the Treasury Bureau of the HKSAR recommend that the existing IRO is amended as proposed and that there are no other options available.²⁹ In effect, this is an admission of being 'backed into a corner' with the only exit being greater cooperation, transparency and information exchange.

The proposals in the Bill have already been subject to limited prior 'public' consultation. In May and June 2012, some 50 business chambers and professional bodies were included in a consultation exercise.³⁰ A further round of consultation occurred over November 2012 to January 2013, including tax and accountants' associations, banking and insurance associations, and chambers of commerce.

²⁷ See OECD, *Global Forum for Transparency and Exchange of Information for Tax Purposes: Phase One: Hong Kong, China 2011* (OECD, Paris, 2011).

²⁸ Legislative Council Brief, Inland Revenue Ordinance (2013).

²⁹ *Ibid*, at para 18.

³⁰ The HICPA released its submission as part of the consultation on the legislative framework to allow the HKSAR to enter into TIEAs. Overall it was supportive, but suggested that there gaps in the necessary safeguards to protect taxpayers. It emphasized that the HKSAR Government should retain its focus on entering into DTAs as its priority (focusing on its major trading partners), and that its template for TIEAs (especially with EOI), should be less in scope than that in the HKSAR's DTAs; see HKICPA, *Consultation on Provision of Legal Framework for Entering into Tax Information Exchange Agreements* (Jul 2012). Other organizations to have identified that they made submissions as part of the early consultation process include: American Chamber of Commerce in Hong Kong, Hong Kong Association of Banks, Hong Kong Trustees Association, KPMG Tax Ltd, Law Society of Hong Kong and Taxation Institute of Hong Kong.

The conclusion reported in the LegCo brief is that in general the various stakeholders supported the proposed approach to enhance EOI under the DTA framework and to enable a legal framework for TIEAs.³¹

During the early phases of LegCo's deliberations, matters for clarification were sought by the Legal Services Division, from the HKSAR's Financial Services and the Treasury, over particular terminology, including use of the phrase "administration or enforcement of the law" as compared to "tax assessment".³² Furthermore, changes to the Personal Data (Privacy) Ordinance (Cap. 486) were raised. Various minor drafting issues were also highlighted. The most interesting point for this paper is a request by the Legal Services Division for details on what sanctions could be imposed on the HKSAR by other members of the Global Forum if HKSAR failed the Phase 2 Review.

In response, Financial Services and the Treasury sought to offer reassurance to the Legal Services Division over the matters raised, emphasizing that the wording follows the OECD's EOI terminology. The emergence of a 'lesson' in grammatical legalese emerges in the response over the various minor drafting issues. Responding to the query of what may occur should the HKSAR fail in its Phase 2 Review, Financial Services and the Treasury reemphasized the risk of the HKSAR being labeled as an uncooperative jurisdiction and that unilateral sanctions could be imposed on the HKSAR. The comments then reflect upon past OECD practice, whereby the Global Forum had indicated that the HKSAR faces the "... risk of being sidelined by the international community."³³ In relation to the unilateral sanctions that may be imposed, Financial Services and the Treasury suggest that these may include:³⁴

"... disclosure and documentation requirements for transactions; imposition of or higher withholding taxes on payments; denying deductions for payments made to entities concerned; and transactions subject to transfer pricing regulations or anti-abuse rules."

In the Legislative Council Briefing Paper of 7 May 2013,³⁵ extensive background to EOI developments was provided, along with an overview of the deliberations of the Panel on Financial Affairs. This Briefing Paper observes that there was both concern and reservations expressed over the proposed expansion of the EOI regime and introducing the TIEA mechanism. The concern was

³¹ Ibid, at para 22.

³² Legal Services Division (LegCo), Correspondence sent to Financial Services and the Treasury (19 April 2013).

³³ Financial Services and the Treasury, Correspondence sent to Legal Services Division (2 May 2013).

³⁴ Ibid.

³⁵ Legislative Council, Bills Committee on Inland Revenue (Amendment) Bill 2013: Background brief prepared by the Legislative Council Secretariat" (7 May 2013).

such that with the HKSAR's tax regime being so different to that of other jurisdictions, and the risk of jeopardizing the attractiveness of the HKSAR as an international financial centre to foreign investment, this unique environment needed to be protected thereby suggesting that these proposals should not go ahead. The Legislative Council (referred to as the Administration) was warned against being too proactive in bringing the EOI arrangements on par with the international standard. Rather, change should only be made where it is absolutely necessary, such as to avoid the imposition of unilateral sanctions on the HKSAR or a negative impact on the diplomatic relations between the HKSAR and other jurisdictions.

A further concern identified in this Briefing Paper is the practicability of tracing and exchanging tax information that was generated a long time before the effective date of the relevant DTA/TIEA agreements. The suggestion was that the information to be exchanged for tax purposes would only cover those after the effective date of the relevant provisions of DTA/TIEA.

In response the Administration emphasized that the HKSAR would only meet the minimum requirements even if the legislative proposals were passed. It would restrict the EOI article in its DTAs to the three direct taxes in the HKSAR (profits tax, salaries tax and property tax). To this end, it was acknowledged that the HKSAR may come under pressure by other jurisdictions to expand this to include other taxes, such as value added taxes (VATs) and inheritance taxes. For instance, the HKSAR would:³⁶

“... still not entertain requests for tax information relating to retrospective tax assessments; tax examinations abroad; and assistance in the collection of taxes which were considered as desirable in the 2012 version of the OECD's Model Tax Convention and its Commentary.”

The Administration further emphasized that the current proposal still upheld the policy that EOI requests would not be permitted to be retrospective in relation to when an agreement became effective.³⁷ This would be maintained as the proposals only relaxed the limitation on disclosure slightly, by allowing the Commissioner to disclose information in response to an EOI request only if he was satisfied that such information related to tax assessments in respect of any period after the date on which the relevant DTA/TIEA came into operation. The Administration also advised that it would retain as its policy priority in the future to expanding the HKSAR's network of DTAs with its major trading and investment partners, (rather than negotiating TIEAs), as this would deliver the greatest economic benefit to the HKSAR.

³⁶ Ibid, at 7.

³⁷ Ibid.

In relation to privacy protection, the Administration further emphasized³⁸ that an EOI would be conducted on a case-specific basis and prudent safeguards had been put in place to protect the confidentiality of the information exchanged. In this regard, the IRD would be required to carefully consider requests for tax information based upon a set of prescribed criteria, including whether the information under request was directly related to tax purposes and within the coverage of DTAs or the future TIEAs. In a further move to placate the concerned members, the Administration emphasized that if treaty partners were considered to have violated their obligations, including the confidentiality requirements, then the HKSAR would, if warranted, take what was considered to be necessary action against the treaty partner. This could extend as far as terminating the relevant DTA/TIEA, something which would be drastic and have widespread ramifications from both diplomatic and investor confidence perspectives.

The Administration also advised³⁹ that the Commissioner would be required to inform the taxpayer concerned of the disclosure request from DTA or future TIEA partners. The taxpayer would be permitted to request a copy of the information that Commissioner was prepared to disclose, and to amend the information if it was factually incorrect.⁴⁰ The proposed Disclosure Rules also provided for a review system in handling appeals, whereby the taxpayer in question might request Financial Services to direct the Commissioner to make the amendments to the information to be disclosed.

As at the time of writing in early June 2013, there remains much to be done if the Bill is to become an amendment to the IRO. Once the Bills Committee has completed its scrutiny of the Bill, then the debate on the Second Reading needs to resume at a subsequent LegCo meeting. During the debate, members will present their views on the general merits and principles of the Bill and may indicate their support or otherwise, following which a vote will be taken. Given the debate to date following the gazetting of the Bill, and the level of concern expressed by various commentators, the outcome of this vote may not be as certain as one might expect for a Government bill. Assuming a motion for the Second Reading of the Bill is passed, the Bill is committed to a Committee of the whole Council. The Committee will need to work through and vote on every clause of the Bill (and any amendments to it). Fortunately the size of the Bill suggests that the number of clauses to be debated is not significant. After the Bill passes through the Committee of the whole Council (with or without

³⁸ Ibid.

³⁹ Ibid.

⁴⁰ With the HKSAR being 'strongly persuaded' to expand its current enter EOI and enable TIEAs, it will likely implement this in a way which narrows their application and places hurdles which may make another revenue authority think twice before requesting information from the HKSAR IRD. These particular provisions are not common to most other jurisdictions in terms of EOI requests and reflect the HKSAR's approach to privacy, and not necessarily a reluctance to alter its EOI standard and provide for TIEAs.

amendments), it is reported back to LegCo for it to consider whether to support the passage of the Bill by giving it the Third Reading. Assuming a positive response, then the Third Reading of the Bill will proceed. Having received the Third Reading, the Bill will then be submitted to the Chief Executive for signature, promulgated in the Gazette and will become enacted law, in this case an amendment to the IRO, plus to the existing privacy ordinance. Then, in accordance with the Basic Law, the enacted amendment must be reported to the Standing Committee of the National People's Congress in China for record.

In relation to the position of the Bill as at the time of writing, the Chairman of the Bills Committee has requested the Government provide related documents regarding the questions raised by the members for its 31 May 2013 meeting. A public hearing was then held on 3 June 2013, at which interest groups were invited to present their opinions.⁴¹ The Bills Committee has made available on its website 19 submissions, 18 of which are in English. In addition, at the Bills Committee meeting on 3 June 2013 (at which the writer was present), three further organizations gave oral submissions, with five of those that provided written submissions also delivering their submissions orally. The Chair of the Bills Committee requested that copies of all oral submissions (plus any outstanding written submissions) be made available to the Bills Committee. As at the time of writing written copies of these oral submissions have yet to be made publicly available. The follow table outlines the key issues raised in the written submissions that are available, as at 30 June 2013, on the Bills Committee's website.⁴²

⁴¹ See further <http://harbourtimes.com/openpublish/article/legco-round-may-21> (visited 29 May 2013). See also the Bills Committee website: <http://www.legco.gov.hk/yr12-13/english/bc/bc07/agenda/bc0720130603.htm> (visited 29 May 2013).

⁴² <http://www.legco.gov.hk/yr12-13/english/bc/bc07/agenda/bc0720130603.htm> (accessed 4 June 2013). Oral submissions were given by The Lion Rock Foundation, Hong Kong Small & Medium Enterprises Association, Hong Kong General Chamber of Commerce, Hong Kong Trustees Association, The Taxation Institute of Hong Kong, Hong Kong Investment Funds Association, the American Chamber of Commerce in Hong Kong and the Hong Kong Association of Banks. All submitters spoke for less than 4 minutes. The second, fifth and sixth mentioned submitters delivered their addresses in Chinese and were translated concurrently into English; thus the analysis is based on the accuracy of the translation. The first two listed organisations left after delivering their submissions while all of the others stayed until after the Administration had the opportunity to answer and ask questions.

Table 1: Written submissions on the Income Tax (Amendment) Bill 2013⁴³

Submitter	View on Bill: TIEAs, transparency	View on privacy protections	Priority for DTAs over TIEAs	Judicial oversight needed?	Made prior submission?	Other issues
Hong Kong Trustees Association	Supports Bill, TIEAs, notes Global Forum's work	Greater safeguards needed	n/c	Yes	Yes	DIPN 47 insufficient; 'control' meaning, must protect privilege
The Taxation Institute of Hong Kong	Supports Bill, TIEAs, notes Global Forum's work	Greater safeguards needed	Yes	Yes	Yes	Issue of 'control'
Hong Kong Investments Funds Association	Supports Bill, TIEAs	Satisfied with provisions	n/c	n/c	n/c	n/c
American Chamber of Commerce in Hong Kong	Supports Bill, TIEAs, notes Global Forum's work	n/c	n/c	n/c	Yes	Important for competitiveness
The Hong Kong Association of Banks	Supports Bill, TIEAs, notes Global Forum's work	Satisfied with provisions	Yes	n/c	Yes	'scope' is ok, competitiveness, not retroactive, DTAs not sufficient
The Law Society of Hong Kong	Supports Bill in part, limit TIEA scope, notes Global Forum's work	Major concerns, much greater safeguards needed	Yes	Yes	Yes	DIPN insufficient, look at Singapore, legal issues
<i>David Lai</i>	<i>Does not support Bill</i>	<i>Not sufficient</i>	<i>n/c</i>	<i>n/c</i>	<i>n/c</i>	<i>Against sovereignty; competitiveness; individual's permission</i>
Association of Chartered Certified Accountants Hong Kong	Supports Bill, TIEAs	n/c	n/c	n/c	n/c	Keep scope narrow, drafting of 'possession', information
Capital Markets Tax Committee of Asia	Supports Bill, TIEAs	n/c	n/c	n/c	n/c	n/c

⁴³ This details the submissions available as at 7 June 2013; n/c is no comment. The submission for the Chinese Manufacturers Association of Hong Kong is in Chinese, with three other organizations (The Lion Rock Association, The Hong Kong Small and Medium Enterprises Association and the Hong Kong General Chamber of Commerce) noted in this list, but with no written submissions available. These are in the order as they appear on the Bills Committee's website agenda. The submission for the International Chamber of Commerce is a copy of their prior submission made during the consultation process in July 2012 as they are still gathering feedback.

Submitter	View on Bill: TIEAs, transparency	View on privacy protections	Priority for DTAs over TIEAs	Judicial oversight needed?	Made prior submission?	Other issues
Chinese Manufacturers Association of Hong Kong						
German Industry & Commerce Ltd/German Chamber of Commerce, Hong Kong	Supports Bill, TIEAs, discusses transparency	n/c	n/c	n/c	n/c	Consider Singapore's actions
Hong Kong Securities Association	Supports Bill, TIEAs, with minimum EOI	Satisfied with provisions	n/c	n/c	n/c	n/c
KPMG Tax Ltd	Supports Bill, TIEAs, notes Global Forum's work	Greater safeguards needed	Yes	n/c	Yes	Suggests TIEAs with Cayman Islands & British Virgin Islands
Hong Kong Institute of Certified Public Accountants	Supports Bill, TIEAs, notes Global Forum's work	Greater safeguards needed	Yes	Possibly	Yes	DIPN insufficient, more guidance on TIEA framework, clearer policy needed, concern over nontax authority use of information
International Chamber of Commerce Hong Kong	Support concept of limited use of TIEAs	Need to have sufficient safeguards	Yes	n/c	Yes	Narrow focus for EOI, need LegCo to approve case for a TIEA
Federation of Hong Kong Industries	Support concept to preserve Hong Kong's status	Generally satisfied with provisions	Yes	Yes	n/c	DIPN insufficient
The Society of Chinese Accountants and Auditors	Support concept of limited use of TIEAs	Greater safeguards needed	n/c	n/c	n/c	'control' meaning, other party meet reasonable costs, 'foreseeably relevant'
<i>Hong Kong Bar Association</i>	<i>Does not support the Bill</i>	<i>Much greater protection needed</i>	<i>n/c</i>	<i>Yes</i>	<i>Yes</i>	<i>Case not made for being 'uncooperative'</i>
Office of the Privacy Commissioner for Personal data	n/c	Need to align Bill with existing law	n/c	n/c	Yes	Requesting party's purpose, offences overseas, information

From the above summary of the written submissions in Table 1, there is support for the Bill in principle (one two are clearly opposed).⁴⁴ Comments on the level of privacy safeguards are mixed, with the tax and legal-based organizations expressing concern and a need to ensure that the current level of protection is not reduced, and the banking and commercial organizations generally satisfied or made no comment. Where a comment was made, submitters supported a policy of prioritizing further DTAs over TIEAs. Four submitters specifically recommended that judicial oversight to information requests be incorporated into the Bill by way of amendment. Other comments made during the oral submissions included the need to avoid the risk of sanctions of the HKSAR being viewed as an uncooperative jurisdiction, to ensure that the HKSAR retains its competitiveness (including a comparison to that of Singapore), and that the EOI reform needs to be done in time for the Phase 2 Peer Review, necessitating prompt enactment.

In its response,⁴⁵ the Administration commented that of the submissions received, most supported the Bill, with an observation that there was a preference for the HKSAR to pursue DTAs over TIEAs, with the Bill's enactment needing to be expedited in the light of the upcoming Phase 2 Peer Review.⁴⁶ The Administration confirmed it would prioritize DTAs with its trading and investment partners, but cannot preclude the possibility of entering into a TIEA with some jurisdictions. The issue of privacy of information was a major issue of discussion, with an undertaking that this would be a high priority in treaty negotiations, with the HKSAR to do all possible to protect the privacy of its residents in EOI.⁴⁷ It would also seek to ensure that existing forms of protection for legal

⁴⁴ Indeed the submission of Mr David Lai is unusual being the only one by an individual rather than an organization, and the only one that appears to fail to recognize the implications for the HKSAR if it were not to reform its EOI facility and permit the negotiation of TIEAs. The submission from the Hong Kong Bar Association reinforces their well-established opposition to further EOI and their view that the Administration has failed to establish that TIEAs will not reduce the HKSAR's competitiveness. Furthermore, of those that delivered an oral submission, only the Lion Rock Foundation was opposed to any changes in EOI beyond that currently provided for in DTAs. This organization also appeared to have a 'chip on its shoulder' about Western World ideals.

⁴⁵ A copy of the Administration's Responses to Written Submissions from Deputations (Administration's Response) is available on the Bills Committee website at: http://www.legco.gov.hk/yr12-13/english/bc/bc07/papers/bc07_d.htm (accessed 5 June 2013). A follow up response to the Hong Kong Bar Association's submission of 4 June is also available: see Administration's Responses to Written Submissions from Deputations (Second Batch) (Administration's Response No 2) is also available on the Bills Committee website at: http://www.legco.gov.hk/yr12-13/english/bc/bc07/papers/bc07_d.htm (accessed 10 June 2013). The Administration does not accept the Hong Kong Bar Association's reasoning for not supporting the extension of EOI.

⁴⁶ The Administration, in response to the Chinese Manufacturers Association of Hong Kong's concerns over the HKSAR being too willing to enhance EOI via TIEAs and could run the risk of being less attractive to international investors, reiterated the requirements for the forthcoming Phase 2 Peer Review requiring a TIEA framework lest the HKSAR be labelled an uncooperative jurisdiction. EOI standards must be the same under a DTA or TIEA lest the HKSAR be questioned over its sincerity in adopting the prevailing EOI standard. See Administration's Response, above n 45, at 4-5.

⁴⁷ In relation to the issue raised by the Hong Kong Law Society over statutory protection of taxpayers, the Administration commented that it would be seeking to implement subsidiary legislation to ensure safeguards are included in TIEAs, and would extend the current disclosure rules for DTAs to TIEAs. The Administration also sets out the approach it will continue to take for EOI under a DTA or TIEA and explains that the DIPN is designed to better enable the public to understand the safeguards, with the Disclosure Rules binding on the IRD; see the Administration's Response, above n 45,

professional privilege, and commercial and trade secrets would be retained.⁴⁸ With respect to the use of information beyond that of taxation, unless both signatories expressly permitted this in their domestic legislation and in the DTA/TIEA, then this would not be permitted.⁴⁹ Protocols to treaties would be prepared to reflect this and other pertinent issues.⁵⁰ Actions by the HKSAR to terminate agreements would be a last resort measure for cases of ‘abuse’ by the other signatory. The Administration would use the OECD’s Model TIEA as a starting point for the HKSAR’s TIEA negotiations until it has developed its own model. In relation to concern over the application date for future TIEAs and DTAs, it would be made clear that the administration or enforcement of laws under the agreement would only apply concerning taxes imposed after the DTA/TIEA becomes effective. In terms of scope of taxes covered under EOI, the Administration is proposing to extend this beyond the tax types covered in the DTAs to encourage more jurisdictions to negotiate a DTA with the HKSAR. Following the hearing on 3 June 2013, a summary of actions for the Administration to address was provided by the Bills Committee.⁵¹ Following the 7 June 2013 meeting, the Administration provide a further follow up in response to late submissions and issues raised during the Bills Committee deliberations.⁵² The Administration confirmed it would be talking a minimum necessary approach to EOI, that it would adopt similar arrangements in engaging stakeholders in pursuing DTAs/TIEAs, and that it would be charging the requesting party for extraordinary costs incurred in obtaining and providing requested information.⁵³ The Administration reiterated that it was comfortable with the ‘foreseeably relevant’ test for permitting disclosure, and in regard to

at 13-15. In response the Hong Kong Law Society has provided a second submission in which it does not accept the Administration’s Response, and recommends a further clause be inserted into all DTAs and TIEAs similar to that in the Hong Kong-Canada DTA; see Hong Kong Law Society, Bills Committee on Inland Revenue (Amendment) Bill 2013 Further Submission (6 June 2013). It is important to note that Article 35 of the Basic Law gives the right to Hong Kong residents to have confidential legal advice, and to institute legal proceedings in the courts against the actions of the executive authorities and their personnel.

⁴⁸ The Administration noted that legal professional privilege is already protected under section 51(4A) of the IRO (Cap. 112) and therefore no need to separately repeat this safeguard for TIEAs; see Administration’s Response, above n 45, at 17.

⁴⁹ This point is discussed and the scope is laid out by the Administration in relation to the Hong Kong Institute of Certified Public Accountants’ submission. It was also noted that EOI may apply to a person resident in a third jurisdiction (that is, other than the contracting states), which is covered by the prevailing EOI standard; the HKSAR would recognize this; see the Administration’s Response, above n 45, at 17-19.

⁵⁰ The Administration also noted that it would be adopting in practice a positive listing approach to set out the tax types to be covered by each DTA/TIEA.

⁵¹ See Bills Committee on Inland Revenue (Amendment) Bill 2013, *Follow-up actions to be taken by the Administration for the meeting on 3 June 2013*, available at: http://www.legco.gov.hk/yr12-13/english/bc/bc07/papers/bc07_c.htm (accessed 7 June 2013). Further meetings between the Bills Committee and the Administration were scheduled for 7 June 2013 and 14 June 2013. The 7 June meeting’s agenda is a follow up to the 3 June 2013 Bills Committee meeting, with the 14 June 2013 a further follow up to the June 7 2013 Bills Committee meeting.

⁵² See Bills Committee on Inland Revenue (Amendment) Bill 2013, *Follow-up actions to be taken by the Administration for the meeting on 7 June 2013*, available at: <http://www.legco.gov.hk/yr12-13/english/bc/bc07/agenda/bc0720130614.htm> (accessed 14 June 2013).

⁵³ As an appendix to this paper the proposed approach for engaging stakeholders for pursuing DTAs/TIEAS is set out.

compliance with safeguards would be extending the ambit of the IRD's Users Committee such that it would review the IRD's performance with respect to EOI. In relation to the Privacy Commissioner for Personal Data's submission, the Administration examined the proposal in the light of the current protections and was of the view that there were sufficient protections in place and that the Personal data (Privacy) Ordinance (Cap. 486) would not be put at risk. Thus the position of the Administration would suggest that it expects that the Bills Committee should be able to recommend the Bill to LegCo to continue through the legislative process. The Bills Committee reported to LegCo on 26 June 2013, recommending continuation of the Bill's Second Reading, with no Committee Stage amendments proposed. A resumption of the Second Reading, Committee Stage and Third Reading of the Bill by LegCo is scheduled for 10 July 2013.⁵⁴

Overall completion of the process required for this Bill to be enacted is fast becoming 'urgent' if the HKSAR wishes to enact this law change by the end of June 2013 in preparation for the Global Forum's Phase 2 Review, which is due to report in September 2013.⁵⁵ Thus, while we should see some movement on this front in the coming days, the feeling from the Bills Committee meeting is that the Bill will be enacted, with possibly some further safeguards over issue of privacy, and some comments reflecting a priority to negotiate DTAs over TIEAs.

3.2 *Reaction to the Bill outside of the legislative process*

Initial reaction to the Bill has been varied and in some instances the language used very 'colorful'. KPMG takes a neutral stance, emphasizing that LegCo will put the Bill under close scrutiny.⁵⁶ Deloitte suggest that the HKSAR Government has no choice but to meet the EOI standards and enter into TIEAs, with the Bill adopting the minimum approach necessary to safeguard taxpayer privacy and confidentiality of information.⁵⁷

In contrast, the response from HKWJ Tax Partners reflects the concern that the HKSAR has given into OECD pressure.⁵⁸ HKWJ Tax Partners suggest that the previous position of the HKSAR only

⁵⁴ See Bills Committee on Inland Revenue (Amendment) Bill 2013, *Report for Legislative Council House Committee* (26 June 2013); available at: <http://www.legco.gov.hk/yr12-13/english/hc/papers/hc0621cb1-1385-e.pdf>. See also House Committee off the Legislative Council, Agenda for 28 June 2013 meeting; available at: <http://www.legco.gov.hk/yr12-13/english/hc/agenda/hc20130628.htm>

⁵⁵ A summary of the legislative process in the HKSAR is also provided as an appendix to this paper.

⁵⁶ KPMG, Inland Revenue (Amendment) Bill gazetted (2013) *Hong Kong Tax Alert* (April), at 2. See also Mary Swire, "Hong Kong Gazettes TIE Bill" (2013) *Tax News* (15 April); available at: http://www.tax-news.com/news/Hong_Kong_Gazettes_TIE_Bill____60431.html.

⁵⁷ Deloitte, "Hong Kong: Measures taken to allow stand-alone TIEAs and enhance exchange of information" (2013) *World Tax Advisor* (May 24), at 2.

⁵⁸ For an overview of the OECD's efforts to date with respect to what it sees as restoring fairness to the international tax system, see OECD, *Restoring Fairness to the Tax System* (OECD, Paris, April 2013).

entering into DTAs had “become ‘too hot’ for Hong Kong to handle”.⁵⁹ They go on to suggest that with the forthcoming Phase 2 Peer Review, the HKSAR:⁶⁰

“... is obvious [*sic*] afraid to be perceived as being a ‘free rider’ and to be identified as an ‘un-cooperative jurisdiction’ which would be a consequence of holding on to the previous position. This is due to the Global Forum’s opinion that a preference for a Double Taxation Agreement over a Tax Information Exchange Agreement cannot be seen as a reason for refusal to enter into an exchange of information agreement.”

HKWJ Tax Partners also suggest that as a result of this proposed amendment, TIEAs with Australia, Germany, the Nordic Countries and the United States are expected to be concluded in the near future.

Writing in the Harbour Times, Quinlan and Garst suggest that HKSAR has been ‘bombarded’ with threats in an attempt to wear it down, with the latest Bill evidence of acquiescence by the administration to the OECD’s demands.⁶¹ This should not be seen as the last of the pressure, with further initiatives in the process of construction. Cast as the bully, the OECD is seen as unlikely to stop here, with the HKSAR likely to be forced to make further concessions. One likely area of pressure will be for the HKSAR to sign up to the OECD’s Multilateral Convention on Mutual Administrative Assistance in Tax Matters.⁶² The authors suggest that the OECD wants the HKSAR to accept automatic EOI and that while not mandated at present, this situation is likely to change. Quinlan and Garst conclude by examining what is best for the HKSAR:⁶³

“Hong Kong policymakers must now decide what is in the best interests of Hong Kong as they once again consider altering their legal tax framework at the behest of the OECD. With a pro-growth system that doesn’t try to tax beyond its borders, *Hong Kong gains nothing directly through information sharing, but thanks to OECD bullying the nation understandably must consider adopting measures to meet whatever happens to be the so-called international standard of the day*. But lawmakers should also consider that the OECD is constantly moving the goalposts – as soon as one requirement is satisfied, two more are created.

⁵⁹ HKWJ, “Hong Kong Government finally gives in to OECD Pressure” (April 16 2013): available at: <http://www.hkwj-taxlaw.hk/news/?p=440>.

⁶⁰ Ibid, emphasis added.

⁶¹ Andrew F Quinlan and Brian Garst, “Appeasement Unlikely to Save Hong Kong from OECD’s Radical Agenda” (2013) *Harbour Times* (May 9).

⁶² OECD, *Multilateral Convention for Mutual Assistance in Tax Matters* (1988), as amended in 2011 (CETS 127). See also the Council of Europe’s (CoE’s) *Explanatory Report on the Multilateral Convention* (2011). For further discussion on the OECD’s Multilateral Convention, see Sawyer (TRN Conference), above n 2.

⁶³ See note 61 above, emphasis added.

If Hong Kong is serious about holding on to principles like financial privacy, there will soon come a time when the international standard as defined by high-tax nations will require a very hard decision. Like most bullies, the OECD doesn't handle resistance well. Standing up to the OECD is the only strategy that has proven effective. *Simply put, leaders in Hong Kong can either draw a line in the sand against the OECD today, draw a line in the future, or toss their principles out the door. Ultimately, the OECD will settle for nothing less.*"

Work explores the dangers of the new EOI regime. He suggests that the HKSAR has very different motivations to other jurisdictions. In particular, it has little interest in EOI as the HKSAR does not seek to claim income generated offshore. In relation to the influence of the Global Forum, Work argues that it is:⁶⁴

"... in effect, unilaterally imposing an EOI on oneself usable by all Forum members - without the commitment of a DTA from a counterparty. For revenue hungry countries chasing funds around the world, it makes sense to be 'in the club'. *For Hong Kong, it is all pain and no gain. How is Hong Kong reacting?*"

Work suggests that the HKSAR administration is 'rolling over' in an effort to get a good report. He also emphasizes concern expressed by the Hong Kong Institute of Certified Public Accountants (HKICPA) that the move may hinder HKSAR negotiating further DTAs, and whether current DTAs will not be updated or even terminated. Thus "why buy (or maintain) the cow, when you already have all the milk?"⁶⁵ In relation to concerns over the proposal, Work comments:⁶⁶

"Apparently the OECD are a bureaucracy unto themselves, quite independent of their national governments. As Mr. Leung [Chair of the Bills Committee] put it, 'OECD top management want [sic] everyone to be members of the club.' The national governments generally respect Hong Kong's compliance and regulatory environment. *It's [sic] seems to be a case of out of control peer pressure.*"

Work suggests that the HKSAR needs to take the "high road", namely to resist the pressure and defy the OECD and the US. In response the HKSAR is expected to receive much 'finger wagging' which is something he suggests it can live with. Just what will be the path ahead for the HKSAR should emerge over the coming months. One matter is clear; the Phase 2 Peer Review is looming for the

⁶⁴ Andrew Work, "Hong Kong: Giving away the milk, never sold the cow" (2013) *Harbour Times* (May 9) (emphasis added).

⁶⁵ Ibid.

⁶⁶ Ibid (emphasis added).

HKSAR making the decision over whether the Bill will be enacted within the next month, essentially in the form that it was initially gazette, of significant importance.

3.3 *FATCA and its influence on the HKSAR*

The Foreign Account Tax Compliance Act (FATCA) is part of the Hiring Incentives to Restore Employment Act (the HIRE Act) in 2010 by the United States Congress. FATCA is a US initiative to combat tax evasion by US persons holding assets in offshore bank accounts and through other offshore intermediaries. Furthermore, I have commented,⁶⁷ this represents the difficult political environment caused by the deferred prosecution by the US of UBS based in Switzerland. While designed to close down loopholes and increase tax compliance generally by requiring investors to report and pay taxes on their income from US sources, it has seen widespread concern from both US-based and overseas commentators, financial institutions and governments. It also represents an evolutionary step in the international tax system according to Grinberg.⁶⁸

In essence FATCA obligates foreign financial institutions (generally offshore banks, private equity and hedge funds and other foreign financial institutions, known as FFIs) to enter into agreements with the Internal Revenue Service (IRS), disclosing the identities of US persons who hold accounts or interests in such FFIs. The failure by an FFI to comply with these rules will result in a 30 percent withholding tax on all (or a portion) of payments made to the FFI. This includes US-source dividends, interest, and capital gains from the sale of US shares and securities (and certain other payments that are not generally relevant to private equity or venture capital funds) by the FFI. One of the myths about FATCA is that it is a tax; FATCA is not a tax but a mechanism to make it easier for the IRS to audit income and assets that would remain hidden offshore.⁶⁹ Thus essentially FATCA is designed not so much to collect tax but rather to compel FFIs and other entities to disclose on an annual basis information about US account holders who may not be complying with US tax reporting rules.

FATCA applies to payments made to FFIs from 1 January 2014 with a phased application over the next three years. Since its original enactment, major developments have been the release of Proposed

⁶⁷ See Sawyer (TRN Conference), above n 2.

⁶⁸ Itai Grinberg, "Beyond FATCA: An Evolutionary Moment for the International Tax System" (2012) *Georgetown University Working Paper* (January 27, 2012). For an updated version of this working paper, see Itai Grinberg, "The Battle over Taxing Offshore Account" (2012) 60 *UCLA Law Review* 304-383. See also Scott D Michel, "FATCA: A New Era of Financial Transparency" (2013) 215(1) *Journal of Accountancy* 52-56.

⁶⁹ Kimberley Tan Majure and Matthew R Sontag, "FATCA: Myths, Mysteries and Practical Perspectives" (2012) 64(4) *The Tax Executive* 315-321, at 315. Majure and Sontag also emphasise that FATCA applies to non-financial companies, that payment of the 30 percent withholding tax will not necessarily be a solution, along with a number of other key practical matters.

Treasury Regulations and then Final Treasury Regulations,⁷⁰ as well as variations on model intergovernmental agreements⁷¹ as concern has grown over the impact on FFIs reporting directly to the IRS.⁷²

The biggest issue with FATCA is the confrontation between FATCA's legal provisions and those of the other jurisdiction, giving rise to conflict of laws issues.⁷³ Soriano suggests that the US Treasury came to its senses and recognised the serious conflicts caused by FATCA and came up with the IGA approach. This approach is expected to solve a number of compliance issues, simplify practical implementation and reduce costs. Importantly, it becomes another step towards automatic exchange, and in some way puts some mutual exchange obligation on the US. Through the Joint Statement⁷⁴ FATCA ceased to be unilateral.⁷⁵

FATCA has received relatively little coverage in the HKSAR. Of interest to the emerging situation in the HKSAR are efforts in the US Congress to repeal FATCA, although the likelihood of their success is minimal, to say the least.⁷⁶ Indeed the HKSAR Government has had little to say about it, although China has declared that it will not be associated with FATCA. However, with China's recent silence it is suggested that it may be contemplating negotiating an IGA with the US.⁷⁷ Smith states that while Chinese authorities have argued that they cannot legally implement FATCA law as it would contravene their own bankruptcy and banking rules, they are no longer answering questions about the subject. Furthermore, officials in the HKSAR, according to Smith, have also become silent on FATCA negotiations. Smith also highlights that: "China is the world's second largest economy and holds a significant amount of US debt and, it is rumored, the US is preparing to make compromises over FATCA to bring China on board."⁷⁸

⁷⁰ Final Treasury Regulations under FATCA were released on 17 January 2013; see Department of the Treasury Internal Revenue Service, *Withholding of Tax on Nonresident Aliens and Foreign Entities* (2013, Publication 515).

⁷¹ US Treasury Department, *Joint Statement from the United States, France, Germany, Italy, Spain and the United Kingdom regarding an Intergovernmental Approach to Improving International Tax Compliance and Implementing FATCA* (2012). The US Treasury released updated versions of the various Model IGAs and Annexes on 9 May 2013. See <http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx> (visited 29 May 2013).

⁷² For further discussion on FATCA, the IGA approach and the emerging literature on FATCA, see Sawyer, (TRN Conference), above n 2.

⁷³ Soriano, above n 8, 551-552.

⁷⁴ See above n 71.

⁷⁵ Ibid, 552.

⁷⁶ See, for example, the proposals to repeal FATCA via a Bill introduced into the US Senate by Paul Rand; further details are available at: <http://www.repealfatca.com/index.asp?idmenu=4&title=News&idsubmenu=124>.

⁷⁷ See Lisa Smith, "China Rumored to be in FATCA Talks with US" (2013); see <http://www.iexpats.com/china-fatca-talks-us/>.

⁷⁸ Ibid.

Indeed, it has been suggested that should China not sign an IGA, then FATCA could unravel; see for example comments by Nigel Green, CEO of deVere Group.⁷⁹ China is seen as playing hardball over FATCA, due in part to the compliance obligations as well as the conflict with its privacy laws. The US is expected to be working behind the scenes to work towards getting China on side. Importantly, China has recognized it has little to benefit from FATCA and potentially much to lose. Interestingly, Green suggests that China would require FATCA to be made reciprocal if it were to agree to an IGA. In relation to the HKSAR, and whether it could act independently of China, Green states:⁸⁰

“It’s currently unclear but there are signs that Hong Kong could indeed act independently from Beijing’s stance as there has been no reference to Hong Kong, a special administrative region (SAR), in any of the published material we’ve seen on the matter.”

The HKSAR does not have its own treaty with the US and is not viewed by the US as being eligible for the benefits of the US-China DTA. If the HKSAR wished to put in place some other form of agreement (eg a TIEA), as already discussed, this would require amendments to domestic legislation (such as with the Bill before LegCo at present). The preamble to the US Treasury Regulations for FATCA makes a general reference to “other agreements” that could be entered into between the US and various partners. The latest versions of the Model IGAs released by the US Treasury will now enable the US to enter into IGAs with jurisdictions that do not have a preexisting TIEA or bilateral DTA. The Alternative Investment Management Association (AIMA)⁸¹ indicates that discussions have taken place between the HKSAR and US authorities, with a statement issued by the Financial Services and Treasury Bureau (FSTB) in April 2012 noting and commenting on the financial industry’s concerns.⁸² The FSTB essentially has requested deemed compliance status for many of its FFIIs, and for an extended transition period to enable implementation of FATCA.

AIMA observes that although the HKSAR’s branches of FFIIs and non-Hong Kong organized FFIIs are not established in the HKSAR, there are HKSAR FFIIs that would significantly benefit from inclusion in an Annex 2 of an IGA, including: Hong Kong pension products, Mandatory Provident Fund (MPF) and Occupational Retirement Schemes Ordinance (ORSO). AIMA states that in conjunction with other associations in the HKSAR (on behalf of the fund, insurers’ and trustees’ industries), it has assisted the HKSAR Government in respect of its discussions with the US and the

⁷⁹ Eugene Grygo, “Could China kill FATCA?” (2013) (February 21); available at: http://www.ftfnews.com/could_china_kill_fatca.

⁸⁰ Ibid.

⁸¹ AIMA, *AIMA Guidance and FAQs on the Foreign Account Tax Compliance Act (FATCA)* (May 2013), at 12.

⁸² FSTB, *Hong Kong’s Position on US Foreign Account Tax Compliance Act (“FATCA”)* (April 2012).

FSTB's industry comment letter.⁸³ However, it states that it has not received an update as to the possibility of a US-HKSAR agreement under FATCA.

In their submission on the proposed US Treasury Regulations, representatives from various HKSAR organizations have formed the Joint Industry FATCA Working Group, which emphasizes that negotiating a DTA between the HKSAR and the US is not possible as the HKSAR is not seen as a 'country' by the US.⁸⁴ Interestingly this is not a view held by many other jurisdictions and consequently it has not prevented other jurisdictions from negotiating a DTA with the HKSAR.⁸⁵ Numerous issues are raised for consideration should the HKSAR enter negotiations with the US under FATCA, with a major issue being that Mandatory Provident Funds (MPFs) would be caught by FATCA.

Quinlan and Garst posit that it will not be long before the HKSAR is not only expected to meet the requirements of FATCA, but that FATCA becomes the next international standard required by the OECD.⁸⁶ FATCA is also seen as having much more 'teeth' than the OECD's EOI requirements, and defiance will have real consequences for the HKSAR. In this regard, however, Work takes an interesting stance, suggesting that the HKSAR is compliant via its DTAs and that other jurisdictions are the holdouts:⁸⁷

“Rather than Hong Kong being the sole Global Forum jurisdiction that is holding out, America, Germany and Australia are the DTA hold-outs against fully compliant Hong Kong. *The high road may not stand against real politik, but sometimes, it is the only road one has.*”

Furthermore, Work observes:⁸⁸

In fact, Hong Kong needs to become compliant with FATCA - the Americans' Foreign Account Tax Compliance Act. With it, the Americans have effectively strong-armed the world into offering up financial information on the pain of being blocked from transacting with American linked financial institutions. Which includes pretty much everyone using USD

⁸³ Ibid.

⁸⁴ While this is true in a sense, the HKSAR is a Special Administrative Region of China; this does not mean that other jurisdictions, including the US, cannot enter into agreements with the HKSAR other than by way of a DTA. Interestingly, Taiwan also does not have a DTA or TIEA with the US, although it is recognized by the US in terms of negotiation to enter an IGA under FATCA.

⁸⁵ Joint Industry FATCA Working Group, Preliminary Views and Comments on the Proposed Regulations of the US Foreign Account Tax Compliance Act (FATCA) (29 February 2012).

⁸⁶ Quinlan and Garst, above n 61.

⁸⁷ Work, above n 64 (emphasis added).

⁸⁸ Ibid (emphasis added).

[sic]. *Given that Hong Kong has no choice (save exiting the global financial system), it might as well enact the legislation to be compliant in time for the 2014 deadline.*”

The Centre for Freedom and Prosperity, in a 2012 blog,⁸⁹ reports that the CEO of the Hong Kong Securities and Futures Commission (HKSF) has warned against allowing the US and European fiscal imperialism in Asia, and is encouraging resistance against FATCA’s implementation. In a seminar in the HKSAR in May 2012, the view was put that there is no going back and that Asian institutions are ‘ensnared’ by FATCA.⁹⁰ FATCA, at some 400 pages in length, is potentially longer than the revenue statutes in Singapore, the HKSAR and Mainland China combined. It was acknowledged that the HKSAR’s financial institutions are generally caught by FATCA, and that FATCA’s requirements conflict with the personal data privacy laws in the HKSAR. In the view of the seminar presenter, Richard Wiesman, a lawyer with Baker and McKenzie in the HKSAR, “China, Hong Kong and Singapore would ultimately comply with FATCA – subject to statutory modifications and simplifications”.⁹¹

More recently in February 2013, one concern has been alleviated for the HKSAR, namely that with the Final Treasury Regulations, most of the largest pension schemes will escape FATCA, including the MPFs.⁹² Sally Wong, CEO of the Hong Kong Investment Funds Association (HKIFA), called for the HKSAR Government to sign an IGA with the US to provide further clarity. She is reported as stating that: “We hope the Hong Kong government will sign an IGA with the US government, and included in the annex to the IGA will be a list of exempt institutions/products such as MPF and Apifs”.⁹³

As at February 2013 no country in Asia had yet signed an IGA under FATCA with the US. However, in the intervening months, Japan is in the process of finalizing its agreement, while Malaysia, Singapore and South Korea are actively engaged with the US Treasury in discussions to do so.⁹⁴ On April 8, 2013, Taiwan announced that it was negotiating a FATCA IGA. This was seen as

⁸⁹ See Hong Kong Stands Up to FATCA Menace; <http://freedomandprosperity.org/2012/blog/hong-kong-stands-up-to-fatca-menace/>.

⁹⁰ Richard Wiesman, *No going back: Asian institutions ensnared by FATCA, Hong Kong seminar hears* (Thomson Reuters, 2012).

⁹¹ Ibid.

⁹² Hong Kong Business (1 February 2013); at <http://hongkongbusiness.hk/economy/news/fatca-exemptions-hong-kong-retirement-funds>.

⁹³ Ibid.

⁹⁴ Also within the wider Asia-Pacific region, Australia and New Zealand are both in the process of negotiating IGAs – see further Sawyer (TRN Conference), above n 2.

significantly reducing the compliance costs for FFIs. In contrast to the HKSAR stance, a comment is made that:⁹⁵

“Taiwan’s authorities stressed that they *are supportive of the underlying goals of FATCA, and are interested in exploring a framework for mutual cooperation to facilitate its implementation*. Both sides have affirmed their willingness to continue their consultations and actively seek to finalize the signing of an agreement.”

Just where this move by Taiwan leaves the HKSAR is a matter for further debate,⁹⁶ although it is suggestive of a further chink in the armor as South East Asian nations commence active negotiations with the US over an IGA under FATCA. As already noted South Korea, Malaysia and Singapore are all in negotiations with the US for an IGA under FATCA. The big issue is what will China do?

4.0 Implications for Hong Kong

Before commenting further on the LegCo proposal and the implications of potential FATCA negotiations for an IGA, it may be instructive to focus on why the HKSAR changed its stance towards EOI and entering into agreements over tax matters. The question over why the HKSAR enters in DTAs is called into question by Rainsford.⁹⁷ He argues that the HKSAR is a tax haven, and imposing the limits of a DTA on it does not affect the HKSAR, but that the other party will be giving up tax revenue. Rainsford suggests that the OECD’s publication of the grey list was likely to have encouraged the HKSAR to modify its domestic legislation and tax treaty policy to commence an expanded DTA network.⁹⁸

Rainsford reviews the HKSAR’s tax treaties, including the HKSAR’s approach to EOI. Of interest is his evaluation of the reasons why a jurisdiction may seek to enter into a tax treaty with a tax haven (both traditional tax related reasons and non-tax reasons), observing that for the other jurisdiction this is a mechanism for reducing effective tax rates and increasing trade, not to reduce double taxation.⁹⁹ The HKSAR has entered into close to 30 DTAs that are “impressively to Hong Kong’s

⁹⁵ Mary Swire, Taiwan, US to Negotiate FATCA Agreement” (2013) Tax News (April 8), at http://www.tax-news.com/news/Taiwan_US_To_Negotiate_FATCA_Agreement____60354.html (emphasis added).

⁹⁶ The HKSAR’s relationship with Taiwan has been a strained one, with some thawing from 2009. This is arguably the ‘closest to home’ influence for the HKSAR outside of the position that China finally decides to take.

⁹⁷ Kyle Rainsford, “Tax Treaties with Tax Havens: The Hidden Tax Break” (2011) 17 *Auckland University Law Review* 60-87.

⁹⁸ Ibid, at 68. As I note elsewhere, amending the HKSAR legislation to enable DTAs to be entered into was a critical part of the Phase 1 Global Forum review (see further Sawyer, above n 18).

⁹⁹ Ibid, at 79-84.

advantage”.¹⁰⁰ This makes the HKSAR an even more attractive tax haven.¹⁰¹ It appears that in response to Littlewood’s question of, how many countries will be willing to negotiate a DTA that gives them little in return and effectively save income from being taxed at all, is significant and sizeable.¹⁰²

In the context of the NZ-HKSAR DTA,¹⁰³ Rainsford expresses concern over the failure to identify that the real motivations for the DTA is to subsidize inbound HKSAR investment into NZ, while maintaining the lack of transparency by not reporting this form of tax expenditure.¹⁰⁴ I have suggested previously¹⁰⁵ that NZ undertakes a careful cost-benefit analysis when it enters into a DTA. In the case of the HKSAR, it would appear that the benefits can only be considered to outweigh the costs if a much wider perspective is taken, similar to that suggested by Rainsford. For example, that from a tax perspective it makes no sense for NZ, but that to encourage investment into NZ (as well as facilitate a closer relationship), the DTA’s effective granting of tax expenditures¹⁰⁶ needs to be counterbalanced by enhanced HKSAR investment into NZ.

Kwong and Kun¹⁰⁷ comment on the decision by the HKSAR in 2010 to introduce the Inland Revenue (Amendment) ordinance 2010 to enable the HKSAR to enter into DTAs using the OECD’s 2004 EOI standard. The authors focus on whether there are adequate safeguards for taxpayers in terms of information privacy, and the recommendations following the Global Forum’s Phase One Peer Review. The authors conclude by calling for further dialogue with the intention of ensuring protection such rights but without significantly undermining the purpose of EOI.

Whatever the issues, this is now a matter of history; the HKSAR has an active policy towards negotiating DTAs, and is currently under pressure to expand its process to include TIEAs, enhanced

¹⁰⁰ Ibid, at 86. A total of 7 of these 28 DTAs are yet to come into force, with 5 not meeting the OECD’s current EOI standard.

¹⁰¹ Ibid, at 87.

¹⁰² Michael Littlewood, “The Hong Kong Tax System: its History, its Future and the Lessons it Holds for the Rest of the World” (2010) 40(1) *Hong Kong Law Journal* 65-84, at 78.

¹⁰³ See Inland Revenue (Double Taxation Relief and Prevention of Fiscal Evasion with respect to Taxes on Income (New Zealand) Order 2011.

¹⁰⁴ Ibid, at 85.

¹⁰⁵ See above n 1.

¹⁰⁶ The Urban Institute and Brookings Institution define tax expenditures, in a US context, as follows: “Tax expenditures are revenue losses attributable to tax provisions that often result from the use of the tax system to promote social goals without incurring direct expenditures. How tax expenditures are structured affects both who will benefit from them and how much they will reduce federal revenues.” See http://www.taxpolicycenter.org/taxtopics/Tax_Expenditures.cfm.

¹⁰⁷ Patrick Kwong and Kathy Kun, “Exchange of Information: Is the Right of Taxpayers to Privacy and Confidentiality of Information Adequately Protected under Current Safeguards?” (2012) 16(2) *Asia-Pacific Journal of Taxation* (Autumn/Winter) 35-43.

EOI and face the realities of FATCA. A key point is that perhaps the outside world has recognized the advantages to HKSAR through negotiating DTAs, and that in order to effect some tax benefits of their own, pressure has come to bear on making EOI potentially more effective (through the negotiation of TIEAs) and the US through its FATCA initiative.

Moving onto the present, with the crackdown on Swiss offshore accounts, the reduction in secrecy through agreements entered into by Switzerland with the UK and the EU, will the HKSAR be the next destination for the wealthy to ‘hide’ their income? The HKSAR has a simple and low rate tax system which should be attractive to investors.

Will the pressure on the HKSAR for greater transparency, EOI and cooperation with the OECD, US and EU, mean that this will be a short lived move, if it is to be one at all? As Wang observes in relation to UBS, “Hong Kong has become the Swiss bank’s ‘second home’, and the bank plans to double its assets in Hong Kong to twenty five percent of its total within five years.”¹⁰⁸ Perhaps comments of this nature have encouraged the OECD and the US to focus further on the HKSAR. Indeed, it would appear that the HKSAR is one of very few nations within the Global Forum that does not currently permit the entering into of TIEAs; hence the current pressure to introduce the Bill and give it effect within the current sitting of LegCo, prior to the Phase 2 Peer Review by the Global Forum later this year.¹⁰⁹ The submissions, as analyzed in Table 1, demonstrate an overwhelming support for the Bill in terms of its proposal to facilitate expending EOI to meet the minimum requirements of the OECD, including enabling TIEAs to be entered into. However, this is premised by concerns over the extent of how the enhanced EOI can be used and to ensure enhanced privacy protection for individuals over that proposed in the Bill. Several submitters have also called for judicial oversight of the request for information process where individuals feel concerned with information concerning their affairs that is requested by the overseas treaty partner through the HKSAR’s IRD.

With regard to FATCA, the Chairman of the Hong Kong Securities Association (HKSA), in a letter to the IRS, expressed concern over the implications of FATCA, requesting that Mainland Chinese investors be counted as Hong Kong residents for the purpose of FATCA. He also intimated that the HKSAR may not be able to adopt the IGA approach, which would be a concern if HKSAR FFIs

¹⁰⁸ Emily Wang, “The Opaque Future of Tax Information Sharing Between the United States and China: An Analysis of Bank Secrecy Laws and the Likelihood of Entrance into a Tax Information Exchange Agreement” (2012) 35(2) *Hastings International and Comparative Law Review* 411-428, at 426.

¹⁰⁹ A comment has been raised that the HKSAR Government (through LegCo) may fail to enact the Bill in time for the Phase 2 Peer Review, citing an inability to make all of the necessary legislative changes (including privacy protection in both tax and other areas of the law), and perhaps argue that it is simply not possible for the HKSAR to meet their extended EOI requirements.

must disclose customers' information to IRS without customers' prior consent, since this would be likely to breach the Personal Data (Privacy) Ordinance (PDPO) in the HKSAR.¹¹⁰

The US Consulate General in Hong Kong and Macau, Stephen Young, stated in May 2012 that, the US is mindful that there are approximately 60,000 American citizens in the HKSAR and is aware that an issue of concern is the need for a tax agreement between the US and the HKSAR. Specifically in relation to FATCA, the Consulate General attempts to placate the growing concern, stating:¹¹¹

“While the law and its requirements are rather complex, I wanted to mention today that we have been listening to the concerns of Americans here in our Consular district related to FATCA. Working with the US Treasury and the Hong Kong Government, *we are striving to minimize the burden which the law's reporting requirements place on individuals and financial institutions.*”

Of the two initiatives, arguably FATCA is of more concern and potentially more fiscally costly to HKSAR should it either refuse to enter into an IGA with the US, or prevent its FFIs from disclosing information to the IRS, thereby triggering the 30 percent withholding tax. Such a move would be disastrous and see a flood of funds leave the HKSAR for other jurisdictions. Consequently, what could be an acceptable ‘middle ground’? Enactment of the Bill in substantially its current form (subject to some closer scrutiny over the privacy issues) is imperative. Negotiating for an IGA under FATCA seems warranted,¹¹² especially if Mainland China takes this path. This will require further amendment to the HKSAR's privacy laws, along with the powers granted to the Commissioner. But will it stop here?

The earlier discussion suggests that the OECD (and the US) will continue to seek greater EOI, including automatic exchange. Will the HKSAR be able to hold out and retain its current minimalist approach to EOI? Is holding out a demonstratively justifiable approach to take, or will pragmatism intervene? A critical factor in this regard is whether the HKSAR can, in fact, pursue a path that differs from that of China. With the LegCo and other political organs within the HKSAR effectively ‘controlled’ (or at least significantly influenced) by Beijing and restricted by the scope of the Basic

¹¹⁰ Brian Fund, *Letter to Internal Review Service regarding FATCA* (30 April 2012).

¹¹¹ Stephen M Young, US Consulate General of the United States to Hong Kong and Macau, “America's Renewed Commitment to Asia and what it Means for Hong Kong and Macau”, remarks to the American Chamber of Commerce in Hong Kong (May 3, 2012), (emphasis added).

¹¹² There is a view held that if the HKSAR should enact the Bill, this would also enable it to enter into an IGA under FATCA. This view, I would suggest, is misplaced, in that an IGA would require a separate agreement with domestic legislation to ratify. Other jurisdictions that have DTAs and TIEAS, for example, are also looking to pursue an IGA which remains separate to their existing DTA/TIEA framework and will require separate domestic legislation to ratify the IGA.

Law,¹¹³ then is the HKSAR beholden to the approach China takes to EOI and FATCA?¹¹⁴ China's position, as noted earlier, is one of considerable strength, especially in relation to EOI. As a member of the Global Forum, it has currently signed nine TIEAs,¹¹⁵ and 102 DTAs, indicating not only is it much more actively engaged in EOI, but that it has the necessary legislative environment to conclude TIEAs. In relation to its Global Forum Peer Review, China received a combined Phase 1 and 2 Report in June 2012.¹¹⁶ Thus with respect to the OECD's approach, China appears to be further ahead than the HKSAR, and 'more compliant' with respect to its approach to EOI. In relation to FATCA, China's approach, as noted earlier, has changed from public opposition to one of 'silence', giving rise to speculation of a future announcement over a decision to enter into an IGA under FATCA.

5.0 Concluding Observations

The subject of this paper is both topical and highly political in relation to the legislative and financial environment of the HKSAR. The pressure that the HKSAR is facing 'attacks' in a sense part of what is essentially the attractiveness of the HKSAR to investors and businesses; low tax rates, a hands off government, minimal requirements to exchange information abroad, and much treasured privacy of information. Perhaps in a sense the OECD and US has isolated what drives the HKSAR, and through a targeted focus will be able to assert pressure for reform to what they see as being 'fully EOI compliant'.

Thus the OECD's EOI expectations, buttressed by the pending Phase 2 Peer Review as a Global Forum member, along with the US's oppressive FATCA regime (placated to a degree by the IGA Model), leaves the HKSAR in a vulnerable position. This is made all the worse with the capitulation of traditional tax havens such as Switzerland and other smaller jurisdictions, to meeting EU, US and OECD expectations for greater EOI, transparency and cooperation. The HKSAR is being swept up in this wave and will need to find firm ground if it is to resist. Also of significance is that in June

¹¹³ Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China (1990), in effect from 1 July 1997; available at: <http://www.basiclaw.gov.hk/en/index/>.

¹¹⁴ For further discussion on the influence of China and the HKSAR's interaction with the wider world from both political and economic perspectives, see Lam Wai-man, Percy Luen-tim Lui and Wilson Wong, *Contemporary Hong Kong Government and Politics* (HKU Press, 2ed 2012), especially Chapters 12, 15 and 16. For further analysis of the complex electoral process within the HKSAR Government, see Simon N. M. Young and Richard Cullen, *Electing Hong Kong's Chief Executive* (Civic Exchange, HKU Press, 2010). For an in-depth analysis of the public sector and how it operates in the HKSAR, see Ian Scott, *The Public Sector in Hong Kong* (HKU Press, 2010), especially chapters 2, 3, 7-9.

¹¹⁵ These are with Argentina, the Bahamas, Bermuda, the British Virgin Islands, the Cayman Islands, Guernsey, the Isle of Man, Jersey, and San Marino. Argentina is the old one out here, as many other jurisdictions would have negotiated a DTA with it.

¹¹⁶ OECD, *Global Forum for Transparency and Exchange of Information for Tax Purposes: Combined Phase One and Two: Peoples republic of China 2012* (OECD, Paris, 2012).

2013, the G20 has endorsed the Multilateral Convention as the basis for which the OECD's desired standard of automatic exchange of information should be based.¹¹⁷ The outcome of the Bills Committee hearing on 3 June 2013, and the Administration's response to the depositions, would indicate that the recommendation will be for the Bill to be enacted, with some minor amendments and clarifications. The Bills Committee has recommended no significant change to the Bill.

The gazetting of the Bill, the Administration's response to submitters, and the growing public concern over its scope, suggests that the HKSAR Government is prepared to move further from its current stance over EOI with respect to DTAs, but where (and when) will it stop? While it is highly commendable to stand by one's principles, practical realities may require some degree of pragmatism and diplomacy, which in my view is the approach underlying the Bill. The key may be for the HKSAR to establish how much effort it needs to make to indicate its willingness to be cooperative, but not to the extent that will lead to the demise of the core values of the jurisdiction. This represents a very a very delicate balancing exercise.

It is my expectation that the Bill will make it into law, but not without further debate and outcry over where this will leave the HKSAR. To this end, the HKSAR is 'feeling the heat' and is taking a step out of the metaphorical fire, somewhat unsure of where this will ultimately take it. That is, I do not expect that in enabling TIEAs and bringing its EOI facilities up to the current prevailing standard will be the end of the expectations of the HKSAR from the global community. Clearly the issue of FATCA remains unclear from an HKSAR perspective. Thus in terms of FATCA, the approach that China takes, in my view, will be highly instructive, as will the necessary legislative change to enable the US to negotiate an IGA with the HKSAR if it 'chooses' to go down this path. If China holds out against FATCA, this will give some leverage for the HKSAR. If China should announce it is negotiating an IGA, then this leaves the HKSAR with no real decision other than to pursue its own IGA (which may also necessitate some change in the HKSAR's domestic legislation).

This paper has a number of limitations, the most important being the comments reflect those of an 'outsider', rather than someone closely involved with the HKSAR's political and business activities and negotiations. That said it is an advantage, in that being an outsider, one is more freely to offer a critical realist's perspective without the limitations of secrecy and restrictions on publicly commenting on matters of national importance associated with one's occupation, particularly as a government official or someone closely aligned with the jurisdiction. A more significant limitation is that these are emerging developments and their full impact is yet to come. Thus this paper by no

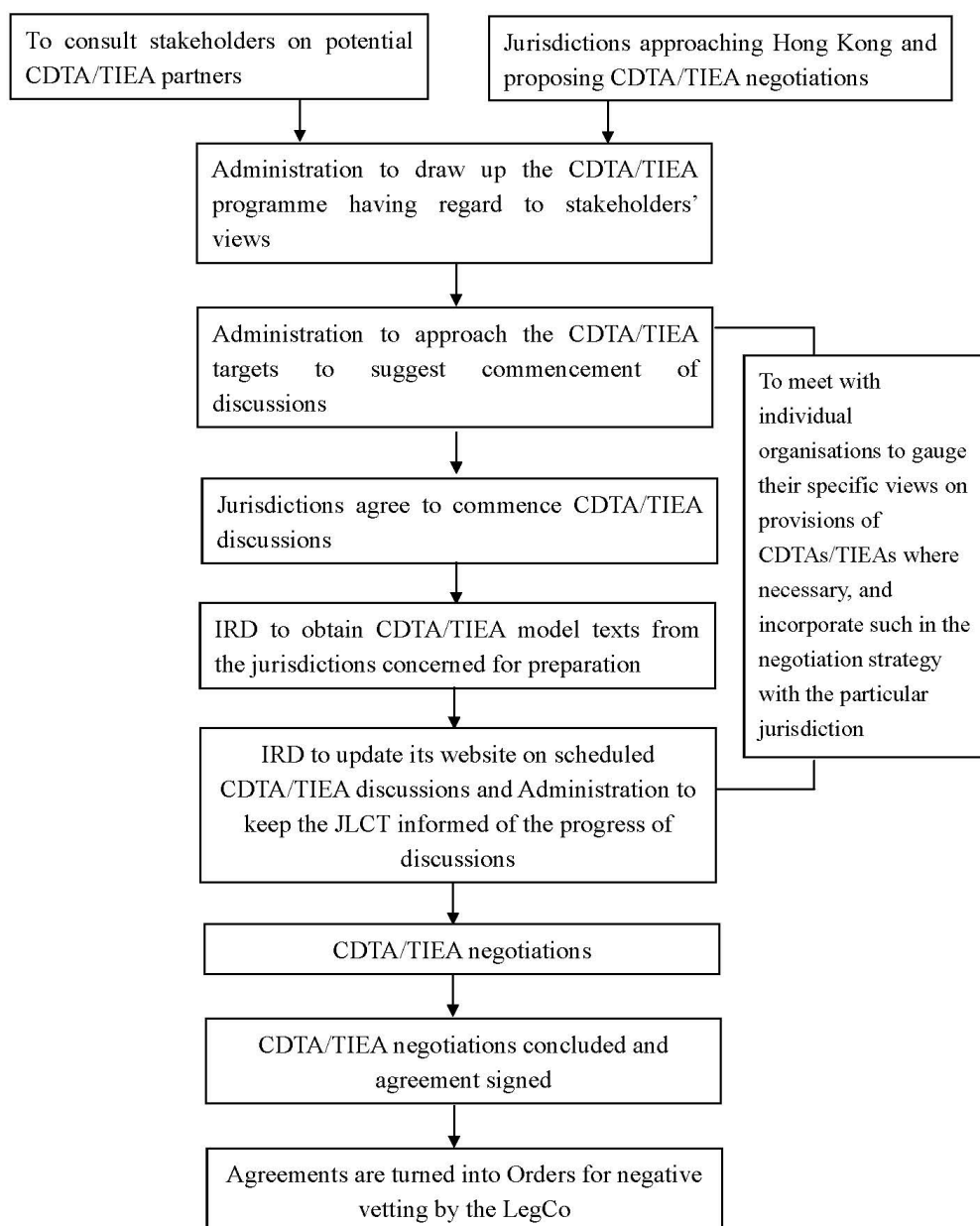
¹¹⁷ OECD, *A Step Change in Tax Transparency: OECD Report for the G8 Summit* (OECD, 2013). The G8 comprises Canada, France, Germany, Italy, Japan, Russia, United Kingdom and United States.

means seeks to be the final word as the issues addressed remain in a state of flux as at the time of writing.

Appendix 1: Flowchart on engagement with relevant stakeholders in pursuing CDTAs/TIEAs

Annex A

Flowchart on engagement with relevant stakeholders in pursuing CDTAs/TIEAs

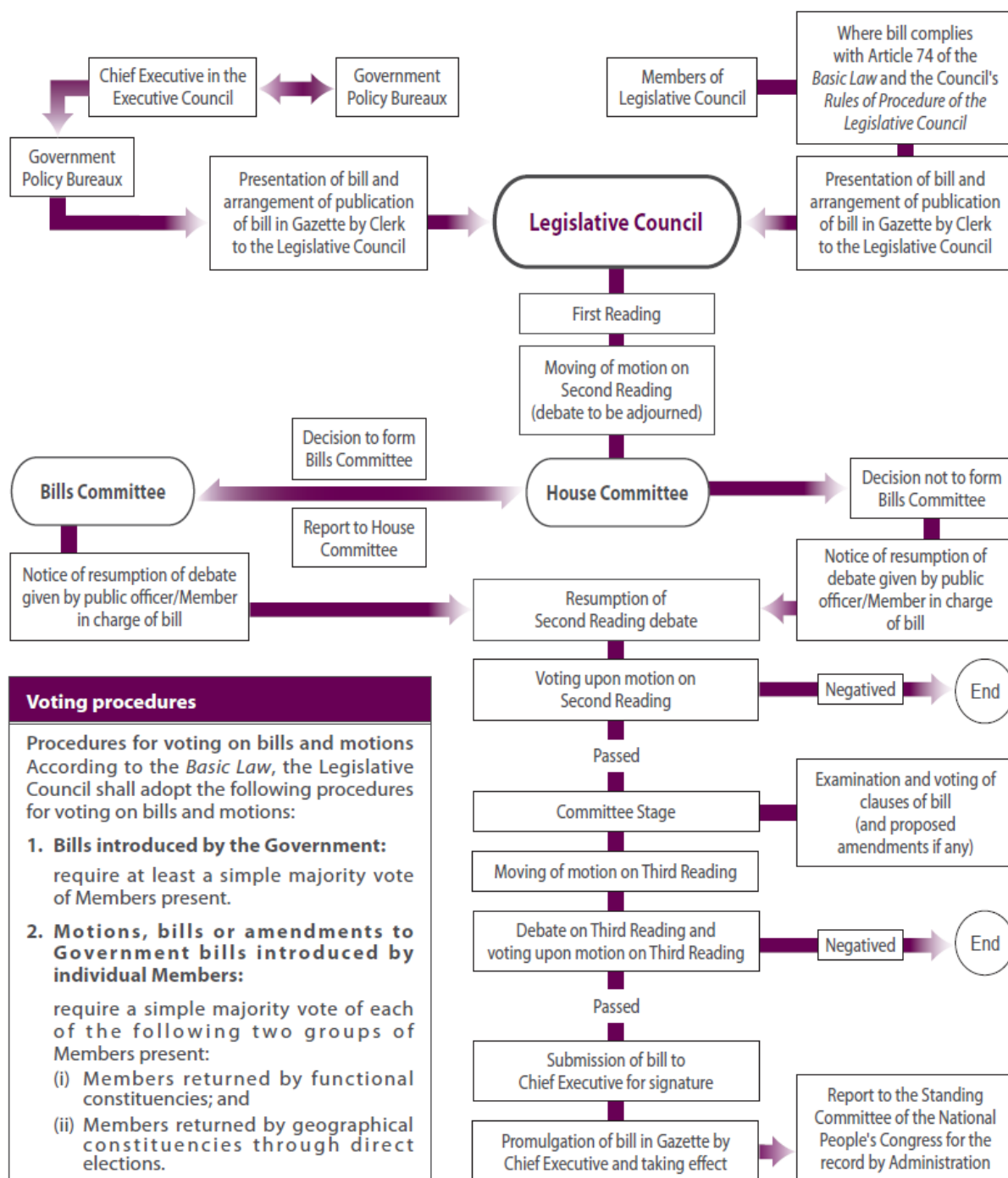


Appendix 2: Overview of the legislative process in the HKSAR

HOW LAWS ARE MADE

LEGISLATIVE PROCESS

Appendix



Further Reference:

LegCo in Brief No. 5/2011-12 – What is a Bill

LegCo in Brief No. 8/2011-12 – How Does the Legislative Council Control and Approve Public Expenditure

Legislative Council Secretariat
Education Service Section
www.legco.gov.hk
May 2012