



International treaty examination of the Second Protocol to amend the agreement for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income with the Government of the Hong Kong SAR of the PRC

Report of the Finance and Expenditure
Committee

February 2018

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Recommendation

The Finance and Expenditure Committee has examined the Second Protocol to amend the Agreement between the Government of New Zealand and the Government of the Hong Kong Special Administrative Region of the People's Republic of China for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income. The committee recommends that the House take note of its report.

The purpose of the Second Protocol is to amend the Hong Kong double tax agreement (DTA) to facilitate automatic exchanges of information between New Zealand and Hong Kong by removing a clause prohibiting automatic exchanges of information. It will allow New Zealand and Hong Kong to meet their international commitments under the G20/OECD Automatic Exchange of Financial Account Information in Tax Matters initiative.

New Zealand has DTAs that provide for automatic exchanges of information with virtually all other jurisdictions, under the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. Hong Kong is currently unable to become a party to this convention. The Second Protocol will bring the New Zealand and Hong Kong DTA in line with New Zealand's DTAs with other jurisdictions.

Appendix A

Committee procedure

This treaty was referred to us on 5 December. We met on 20 December 2017 and 14 February 2018 to consider it. We heard advice from Inland Revenue officials.

Committee members

Michael Wood (Chairperson)
Kiritapu Allan
Andrew Bayly
Tamati Coffey
Rt Hon David Carter
Hon Steven Joyce
Barbara Kuriger
Willow-Jean Prime
Dr Deborah Russell
David Seymour
Fletcher Tabuteau
Dr Duncan Webb
Lawrence Yule

Advice received

The document that we received as advice is available on the Parliament website, www.parliament.nz.

Appendix B

National Interest Analysis

The National Interest Analysis prepared by Inland Revenue is attached.

NATIONAL INTEREST ANALYSIS:**Second Protocol to amend the Agreement between the Government of New Zealand and the Government of the Hong Kong Special Administrative Region of the People's Republic of China for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income****Executive summary**

1. The *Second Protocol to Amend the Agreement between the Government of New Zealand and the Government of the Hong Kong Special Administrative Region of the People's Republic of China for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* ("the Second Protocol") was signed on 15 June 2017.
2. The Second Protocol makes two amendments to the existing Protocol to the Double Tax Agreement with Hong Kong (respectively, "the existing Protocol" and "the DTA") which contains clarifications relating to Article 24 (*exchange of information*). The first will ensure that the *exchange of information* article in the DTA fully reflects the international standard for information exchange as set out in the OECD's Model Tax Convention on Income and on Capital, which forms the basis of New Zealand's negotiation model, and ensure New Zealand is fulfilling the commitment to the G20/OECD *Standard for Automatic Exchange of Financial Account Information in Tax Matters* ("AEOI"). The second corrects a typographical error within the existing Protocol to the DTA.
3. The AEOI initiative is an international response to mounting concerns with the problem of off-shore tax evasion. AEOI implementation in New Zealand is now largely complete with the implementation legislation now in place, and with most of the necessary legal instruments for exchange concluded and in force. However, section 88 of the Tax Administration Act 1994 prevents the new AEOI standard from applying with Hong Kong as disclosure of information to another jurisdiction is only authorised to the extent required under the relevant tax treaty, and paragraph 4(a) of the existing Protocol states that automatic exchanges are not required. As the wording of Article 24 of the DTA otherwise follows the OECD model formulation, deleting paragraph 4(a) will reinstate the full OECD meaning and impose a treaty obligation to engage in automatic and spontaneous exchanges.
4. Once the Second Protocol to the Hong Kong DTA enters into force, a reciprocal treaty obligation will be imposed on both Hong Kong and New Zealand to engage in automatic and spontaneous exchanges. This will allow New Zealand to meet its international commitment to complete first AEOI exchanges by 30 September 2018.
5. It is in the national interest to bring into force the Second Protocol to the Hong Kong DTA as it makes the agreement consistent with New Zealand's other DTAs. Implementing the AEOI standard will impose compliance costs on financial institutions and administrative costs on Inland Revenue; however, this will be balanced by the general benefits to New Zealand of reduced tax evasion by New Zealand residents and enhanced voluntary compliance with tax obligations. Hong Kong is an important international financial centre; to not include Hong Kong as an AEOI exchange partner would leave a significant gap in New Zealand's AEOI network. Further, the compliance with international standards can be expected to enhance New Zealand's international standing.

Nature and timing of the proposed treaty action

6. The *Second Protocol to Amend the Agreement between the Government of New Zealand and the Government of the Hong Kong Special Administrative Region of the People's Republic of China for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* (“the Second Protocol”) was signed on 15 June 2017. It is a bilateral international treaty that amends the *Agreement between the Government of New Zealand and the Government of the Hong Kong Special Administrative Region of the People's Republic of China for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income* signed at Auckland on 1 December 2010, and the Protocol thereto (collectively, “the DTA”).

7. The Second Protocol makes two amendments to the DTA. The amendments pertain solely to the exchange of information article (Article 24) of the DTA. The amendments do not change the wording of Article 24 itself, but rather amend the wording of clarifications relating to that article set out in the existing Protocol to the DTA.

8. The first of the two amendments will ensure that Article 24 fully reflects the international standard for information exchange as set out in the OECD's Model Tax Convention on Income and on Capital. DTA exchange of information provisions are generally understood to oblige the treaty partners to engage in the exchange of information to the widest possible extent. That is:

- Exchange on request. For example, when a tax administration wants to verify that a resident has correctly reported all offshore income and/or transactions, it will seek specific information (such as accounting records or bank information) from the tax administration of the other Party. The requested tax administration must then use its information gathering powers to obtain and provide the information to the requesting tax administration.
- Spontaneous exchanges. For example, when a Party acquires information that is likely to be relevant to the other tax administration (such as knowledge of tax evasion), it will provide the information to that tax administration without having been asked to do so.
- Automatic exchanges. That is, automatic programmes for collecting and exchanging agreed categories of information.

9. Article 24 of the DTA currently falls short of the international standard because it is effectively limited to exchange on request, and does not authorise automatic or spontaneous forms of exchange. This limitation is an impediment to automatic exchanges between New Zealand and Hong Kong under the G20/OECD *Standard for Automatic Exchange of Financial Account Information in Tax Matters* (in short “Automatic Exchange of Information”, or “AEOI”). New Zealand and Hong Kong have made international commitments to commence AEOI automatic exchanges from 30 September 2018.

10. The limitation to Article 24, which is set out in paragraph 4(a) of the existing Protocol, does not expressly prohibit automatic exchanges, but merely states that such exchanges are not required. However, section 88 of the Tax Administration Act 1994 only authorises disclosure of information to another jurisdiction to the extent required under a tax treaty. In this context, the statement in paragraph 4(a) that automatic exchanges are not required means that section 88 effectively prevents automatic exchanges with Hong Kong.

11. The Second Protocol resolves this issue by simply deleting paragraph 4(a). The wording of Article 24 of the DTA otherwise follows the OECD model formulation, which obliges the Parties to exchange such information as is foreseeably relevant to tax enforcement. This formulation is subject to an official OECD Commentary that interprets the wording as imposing a treaty obligation to engage in automatic and spontaneous exchanges. The removal of the limitation at paragraph 4(a) therefore reinstates that full OECD meaning.

12. The second of the two amendments is minor, and merely corrects a typographical error. Paragraph 4(b) of the existing Protocol to the DTA currently contains an incorrect reference to New Zealand's "Office of the Ombudsmen". The Second Protocol updates paragraph 4(b) to reflect the correct title of "Office of the Ombudsman".

13. The Second Protocol also makes a consequential change to the paragraph numbering of the existing Protocol. Following the deletion of paragraph 4(a), paragraph 4(b) is renumbered as paragraph 4.

14. Following completion of each jurisdiction's domestic requirements for entry into force, it is proposed that the Second Protocol be brought into force by means of an exchange of diplomatic notes, in accordance with paragraph 4(2) of the Second Protocol. The full range of steps required in New Zealand for entry into force of the Second Protocol is set out in the following paragraphs.

15. The Second Protocol must undergo Parliamentary treaty examination, in accordance with Parliament's Standing Orders 397-400.

16. After completion of the Parliamentary treaty examination process, the Second Protocol will be incorporated into domestic legislation by Order in Council pursuant to section BH 1 of the Income Tax Act 2007. Section BH 1 provides that such Orders in Council may specify that the provisions of a DTA will have effect notwithstanding any provision of the Inland Revenue Acts, the Official Information Act 1982 or the Privacy Act 1993 – although only in relation to tax matters. Section BH 1 expressly applies only to "double tax agreements". However that term also covers amending protocols, including the Second Protocol.

17. Upon the promulgation of the Order in Council, the Second Protocol will be brought into force through an exchange of diplomatic notes that confirms the completion of the respective constitutional and legal requirements for entry into force of the Second Protocol by each Contracting Party. The Second Protocol comes into force on the date of the last notification, and will have effect from that date.

18. Once the Second Protocol to the Hong Kong DTA enters into force, a reciprocal treaty obligation will be imposed on both Hong Kong and New Zealand to engage in automatic and spontaneous exchanges. This will allow New Zealand to meet its international commitment to complete first AEOI exchanges by 30 September 2018.

19. Like the DTA itself, the Second Protocol will not apply to the Cook Islands, Niue or Tokelau.

Reasons for New Zealand becoming party to the treaty

Background – Double Tax Agreements (DTAs) and exchange of information

20. DTAs are bilateral international treaties that are principally designed to encourage growth in economic ties between countries. DTAs encourage growth in economic ties by reducing tax impediments to cross-border trade and investment. More specifically they provide greater certainty of tax treatment, eliminate double taxation, reduce withholding taxes on cross-border investment returns, and exempt certain short-term activities in the host State from income tax.

21. A secondary function of DTAs is to enable the tax administrations of the treaty partners to assist each other in the detection and prevention of tax avoidance and evasion. DTAs do this primarily by establishing a mechanism for exchanging information between the tax authorities of the treaty countries.

22. For countries such as New Zealand that tax residents on their worldwide income, exchange of information is critical to effective tax enforcement, as it makes it possible to obtain off-shore information to verify that residents are correctly reporting their foreign-sourced income. New Zealand currently has over 100 exchange relationships in force through its various tax treaties, and has an active exchange of information programme under those tax treaties.

23. International efforts to improve transparency and effective exchange of information in the tax context have resulted in a number of recent global initiatives. These include the development and publishing of clear international standards in respect of transparency and exchange of information, and international monitoring and peer review to ensure compliance with those standards. Prior to 2014, the focus of the international monitoring and peer review was on exchange of information on request. With the launch of the AEOI initiative, however, the international focus has now widened to also encompass automatic exchange.

Background – Automatic Exchange of Information (AEOI)

24. G20 leaders launched the AEOI initiative in response to mounting international concerns at the problem of off-shore tax evasion (that is, the ability of individuals and entities to evade tax by hiding their wealth in off-shore accounts). Jurisdictions implement the AEOI standard by enacting legislation that requires their financial institutions to identify accounts held by non-residents and report identity and financial account information in respect of those non-residents to their local tax administration. The tax administrations will then exchange that information to the relevant jurisdiction under tax treaties. The exchanged information will be used to detect off-shore tax evasion. More generally, global implementation of the AEOI standard is expected to deter off-shore tax evasion to a significant degree.

25. New Zealand and Hong Kong have both made international commitments to implement the AEOI standard, and to complete first AEOI exchanges with relevant treaty partners by 30 September 2018. New Zealand's implementation legislation was included in the *Taxation (Business Tax, Exchange of Information and other Remedial Matters) Act*, which received Royal assent on 21 February 2017.

Advantages and disadvantages to New Zealand of the treaty entering into force and not entering into force for New Zealand

Advantages

26. The Second Protocol will remove the existing impediment in the DTA to automatic and spontaneous exchanges with Hong Kong. This will ensure that the exchange of information provisions in the DTA will fully comply with the current international standard and will be consistent with New Zealand's other DTAs. It will also enable New Zealand to engage in AEOI exchanges with Hong Kong and generally to meet its international commitment to complete first AEOI exchanges with relevant tax treaty partners by 30 September 2018.

27. AEOI implementation in New Zealand is now largely complete, with the implementation legislation now in place, and with most of the necessary legal instruments for exchange concluded and in force. However, implementation with Hong Kong is currently lagging behind due to the need to first amend the DTA to remove the impediment to automatic exchanges. The Second Protocol addresses that issue and ensures that New Zealand will be able to commence making AEOI exchanges with Hong Kong at the same time as with other treaty partners.

28. As noted, the AEOI standard was introduced with the aim of facilitating the detection of off-shore tax evasion. The general benefits to New Zealand of implementing the AEOI standard, in financial, fiscal and economic terms, are to reduce tax evasion by New Zealand residents and to support voluntary compliance with tax obligations (through perceptions of a fair tax system in which everyone pays their fair share). In wider terms, compliance with international standards can also be expected to enhance New Zealand's international standing.

29. Hong Kong is an important international financial centre. To not include Hong Kong as an AEOI exchange partner would leave a significant gap in New Zealand's AEOI network, and create opportunities for off-shore tax evasion for New Zealand residents to exploit. The Second Protocol removes that risk and therefore buttresses New Zealand's AEOI regime.

Disadvantages

30. The removal of the existing impediment to New Zealand engaging in AEOI exchanges with Hong Kong will result in New Zealand's AEOI rules being extended to Hong Kong. That, in turn, means that financial institutions will need to report information on Hong Kong residents that hold accounts in New Zealand, and Inland Revenue will need to exchange that reported information with Hong Kong. The Second Protocol will therefore indirectly result in the imposition of compliance costs on financial institutions and administrative costs on Inland Revenue.

31. However, Cabinet considered the compliance cost and administrative cost implications of AEOI implementation when making its decision to commit to the international standard, and determined that the benefits of AEOI implementation outweigh the disadvantages. The costs of including Hong Kong as an AEOI exchange partner are consequential to that decision. Moreover, as a result of the earlier decision, financial institutions and Inland Revenue are now building systems and developing processes to facilitate general compliance with AEOI requirements. The specific costs of adding Hong Kong to New Zealand's list of AEOI exchange partners will be marginal to the larger costs of establishing those systems and processes.

32. On balance, it is considered to be in New Zealand's interests to bring the Second Protocol into force.

33. Note that it is unusual to need to make changes to a tax treaty to facilitate AEOI. For most other AEOI exchange partners, the applicable tax treaty generally already caters for AEOI exchanges without any need for amendment.

Legal obligations which would be imposed on New Zealand by the treaty action, the position in respect of reservations to the treaty, and an outline of any dispute settlement mechanisms

34. The Second Protocol removes an impediment in the DTA to automatic and spontaneous exchanges of information. Removing the impediment effectively imposes a reciprocal treaty obligation on the Parties to engage in automatic and spontaneous exchanges.

35. However, removing the limitation on automatic and spontaneous exchanges in the DTA brings that DTA into step with the rest of New Zealand's DTA network, and with the international standard for information exchange. That is, it effectively assists in creating a level playing field across all of New Zealand's DTAs.

36. Reservations are not provided for under the Second Protocol.

37. The Second Protocol does not contain a dispute-resolution provision, but instead the dispute-settlement mechanisms that are currently in place with Hong Kong under the DTA will also apply to the Second Protocol.

Measures which the Government could or should adopt to implement the treaty action, including specific reference to implementing legislation

38. Subject to the completion of the Parliamentary treaty examination process, the Second Protocol will be implemented into New Zealand domestic law by Order in Council in accordance with section BH 1 of the Income Tax Act 2007.

39. Section BH 1 of the Income Tax Act 2007 enables DTAs (and amending Protocols) to be given effect by Order in Council. Section BH 1 provides that the provisions of DTAs will then have effect notwithstanding anything in the Inland Revenue Acts, the Official Information Act 1982, and the Privacy Act 1993. This override of the Acts is necessary to give effect to the terms of a DTA. The Inland Revenue Acts are overridden to ensure that the secrecy rules that otherwise apply to Inland Revenue in relation to taxpayer information do not prevent exchange of information under tax treaties. The Official Information Act is overridden to ensure that communications with other jurisdictions are not required to be disclosed. The Privacy Act is overridden to ensure that information can be exchanged regarding natural persons under the exchange of information provisions of the DTA.

40. After the Order in Council has entered into force, New Zealand will notify Hong Kong through diplomatic channels that all of its required approval procedures for entry into force of the Second Protocol are complete. Hong Kong will likewise notify New Zealand through diplomatic channels when it has completed its required approval procedures for entry into force of the Second Protocol. The Second Protocol will enter into force on the date of the last notification and its provisions will have effect from that date.

Economic, social, cultural and environmental costs and effects of the treaty action

41. No social, cultural or environmental effects are anticipated. Any economic effects are expected to be favourable, as noted above.

The costs to New Zealand of compliance with the treaty

42. As noted, the removal of the existing impediment to New Zealand engaging in AEOI exchanges with Hong Kong will result in New Zealand's AEOI rules being extended to Hong Kong. That, in turn, means that financial institutions will need to report information on off-shore accounts held by Hong Kong residents, and Inland Revenue will need to exchange that reported information with Hong Kong. The Second Protocol will therefore indirectly result in the imposition of compliance costs on financial institutions and administrative costs on Inland Revenue. However, those will be marginal in terms of the wider costs to financial institutions of AEOI compliance.

43. General costs arising to Inland Revenue from AEOI implementation will be met from funding secured for that project. Any specific costs arising to Inland Revenue as a result of the Second Protocol facilitating AEOI exchanges with Hong Kong will be met from within existing baselines.

Completed or proposed consultation with the community and parties interested in the treaty action

44. The Ministry of Foreign Affairs and Trade and the Treasury have been consulted and agreed with the proposed treaty action.

Subsequent protocols and/or amendments to the treaty and their likely effects

45. No future Protocols are anticipated. New Zealand would consider proposed amendments on a case-by-case basis and any decision to accept an amendment would be subject to the usual domestic approvals and procedures.

Withdrawal or denunciation provision in the treaty

46. Article 2 of the Second Protocol provides that it forms an integral part of the DTA. Accordingly, the Second Protocol will remain in force as long as the DTA itself remains in force.

47. Under Article 27 of the DTA, either Contracting Party may terminate the DTA by giving notice of termination, through diplomatic channels, at least six months before the end of any calendar year. Any decision by New Zealand to terminate the DTA and its Protocols would be subject to the usual Government approvals and procedures.

Agency Disclosure Statement

48. Inland Revenue has prepared this extended national interest analysis. Inland Revenue has undertaken an analysis of the issue of implementing the Second Protocol, and the legislative and regulatory proposals arising from that implementation. Inland Revenue has considered all other possible options in that process, and is of the view that there are no significant constraints, caveats and uncertainties concerning the regulatory analysis.

49. An Order in Council is required to implement the Second Protocol into New Zealand domestic law.

50. Inland Revenue is of the opinion that the policy options considered will not impose unnecessary additional costs on businesses; impair private property rights, market competition, or the incentives on businesses to innovate and invest; or override fundamental common law principles.

Paul Kilford
Policy Manager
Policy and Strategy
Inland Revenue

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