Oxfam Hong Kong's Views on Measures to Counter Base Erosion and Profit Shifting: A Response to the Hong Kong Government's BEPS Consultation

樂施會 OXFAM Hong Kong | 無窮世界 World Without Poverty

December 2016

Fiscal Justice, Fair Taxation and Poverty Alleviation

Oxfam believes that inequality breeds poverty and fiscal justice is a key solution to inequality-induced poverty. Fiscal justice includes raising revenue through taxation, and allocation and spending on public services. Increasing tax revenue allows countries to use and control their own resources to support their national development plans, particularly those that aim to alleviate poverty. Greater domestic resource mobilization can improve governance and accountability, leading to fairer and more equal opportunities to access services for all people. However, at present, almost all countries suffer from increasingly large scale tax dodging schemes used by big multinationals and wealthy individuals: they take advantage of low tax rates, tax exemptions, and loopholes in taxation laws and regulations in their home countries and overseas. These shady practices deprive governments of much needed resources to finance essential services, but this especially affects developing countries[1].

An Oxfam report published in 2014 indicated that multinationals' tax evasion in the form of transfer mispricing cost the Peruvian government HK$26 billion in 2013, which was equivalent to 84 per cent of the country's annual expenditure on education.[2] Another Oxfam report in 2016 showed that the South African government lost about HK$225 billion in tax revenue due to multinationals' tax evasion; this could have been spent on building social housing units for 400,000 families.[3] Ultimately, these shady practices breed extreme inequality. This is unacceptable and has to be stopped. The world needs concerted action to build a fairer economic and political system that values everyone.

In order to push for this change, Oxfam has developed 'Even it Up', a global campaign against rising and extreme economic inequality. Our latest report 'Tax Battles: the dangerous global Race to the Bottom on Corporate Tax'[4], criticises Hong

---

[1] The Global Financial Integrity report (December 2015), "Illicit Financial Flows from the Developing World: 2004-2013" finds that developing and emerging economies lost US$7.8 trillion in illicit financial flows from 2004 through 2013, with illicit outflows increasing at an average rate of 6.5 percent per year—nearly twice as fast as global GDP. http://www.gfintegrity.org/wp-content/uploads/2015/12/IFF-Update_2015-Final-1.pdf

[2] Oxfam report (2014), 'Business among Friends: Why corporate tax dodgers are not yet losing sleep over global tax reform,' https://www.oxfam.org/sites/www.oxfam.org/files/bp185-business-among-friends-corporate-tax-reform-120514-en_0.pdf

[3] Oxfam report (2016) 'Fiscal Justice Global Track Record,' p.26, http://policy-practice.oxfam.org.uk/publications/fiscal-justice-global-track-record-oxfams-tax-budget-and-social-accountability-620087

[4] Oxfam report (2016) 'Tax Battles: the dangerous global Race to the Bottom on Corporate Tax'. http://www.oxfam.org.hk/filemgr/5189/bp-race-to-bottom-corporate-tax-121216-en.pdf

Kong government for inadequate legal and administrative provisions ensuring tax transparency, and ranks Hong Kong as the ninth worst tax haven in the world.

As part of this campaign, Oxfam is calling for greater transparency from multinational corporations when reporting their tax returns, so that cross-border tax evasion and tax avoidance will be reduced and tax revenue collection by governments of developing countries be enhanced.

In response to tax dodging by multinationals, the Organization for Economic Cooperation and Development (OECD) has been leading the ‘Base Erosion and Profit Shifting’ (‘BEPS’) international corporate tax reform package. Regarding the Hong Kong government’s current consultation with the public on measures to counter BEPS, Oxfam welcomes its commitment to implementing the BEPS package as the first important step towards contributing to a fairer international tax environment. Oxfam urges the Hong Kong government to adhere to the highest international standards and address the following points of concern in the Consultation Paper:

1. Being a member of the BEPS inclusive framework, the Hong Kong government says in the Paper that it will take a pragmatic approach to the implementation of the 15-action BEPS package, including the four ‘minimum standards’. The OECD allows non-members like Hong Kong to adopt a phased approach to implement BEPS actions; the government has also expressed commitment to implementing other action plans. Nonetheless, **the government has not provided a timetable for implementing these other BEPS actions.**
2. The Hong Kong government proposes in the Paper that the maximum penalty for non-compliance with transfer pricing adjustment requirements is a fine between HK$10,000 and HK$50,000 in addition to treble the amount of tax undercharged, and imprisonment in case of wilful intent to evade taxes. The government also proposes that the maximum penalty for non-compliance with transfer pricing documentation requirements (including those on the master file, local file, and country-by-country reports) is a fine of HK$100,000 plus HK$500 per day of delay. These penalties may seem stricter than those adopted by many other tax jurisdictions, which focus on penalising underreporting income as a result of non-arm’s length transfer pricing, rather than penalising the lack of transfer pricing documentation. However, **as one of the world’s worst tax havens where billions of corporate incomes are evaded and avoided, Hong Kong needs to implement tougher measures than the current proposals to deter multinational corporations from non-compliance.**

3. **The Hong Kong government does not recommend the automatic exchange of country-by-country reports with other tax jurisdictions based on Multilateral Convention on Mutual Administrative Assistance in Tax Matters (MCMAA)**, an agreement that has been joined by over one hundred tax jurisdictions. By basing the automatic exchange of country-by-country reports on bilateral instead of multilateral agreements, the government would slow down the process of exchanging reports with all other jurisdictions. This demonstrates its lack of commitment to implementing relevant BEPS actions.
4. The Hong Kong government proposes that multinational corporate taxpayers are entitled to safeguarding their privacy based on bilateral agreements such as Comprehensive Avoidance of Double Taxation Agreements (CDTAs) and Tax Information Exchange Agreements (TIEAs). In fact, BEPS Action 13 envisions the sharing of information solely between tax authorities, and requires countries to put in place legal protections to ensure confidentiality of the country-by-country information exchanged. Nonetheless, **given the increasing public concern with corporate tax dodging, the Government should have recommended a <u>PUBLIC</u> country-by-country report by multinational corporations.**
5. In the Paper, the Hong Kong government **does not specify what will be included in a country-by-country report. It also does not explicitly state what international standards it will adhere to when establishing requirements on what needs to be included in a country-by-country report.** That said, it does make numerous references to the OECD country-by-country reporting template to imply adherence to OECD standards.
6. The Hong Kong government mentions its commitment to conducting the automatic exchange of financial account information in tax matters ('AEOI') with appropriate jurisdictions based on bilateral agreements such as CDTAs and TIEAs. The AEOI mechanism that Hong Kong has been implementing involves the exchange of financial account information and tax rulings, but not the mandatory disclosure of aggressive tax planning schemes as envisioned in BEPS Action 12. In the Paper, the **Hong Kong government makes no commitment to implementing BEPS Action 12, which should include the sharing of and free access to beneficial ownership information.**[5]

In light of these, Oxfam urges the Hong Kong government to ensure the timely passage of legislative amendments with all-out effort, and also to demonstrate its full

[5] "OECD Highlights Tax Transparency and Beneficial Ownership," https://tax.thomsonreuters.com/blog/checkpoint/OECD-Highlights-Tax-Transparency-and-Beneficial-Ownership

commitment to the BEPS tax reform by fully addressing the concerns listed above.

Inadequacies of Hong Kong BEPS Implementation Proposals

1. **No applicable BEPS actions having been implemented:** Among major tax jurisdictions (either members or non-members of the OECD), Hong Kong is one of the few to have implemented (or is in the process of implementing) the no BEPS action plans (see Appendix 1), aside from the inapplicable Action 3 ('designing effective controlled foreign company (CFC) rules') and Action 11 ('measuring and monitoring BEPS'). Singapore, a non-OECD member like Hong Kong, has not implemented many BEPS actions, but it has at least updated its transfer pricing documentation guidelines (effective January 2015) according to the OECD's recommendations on Action 13, and announced the implementation of country-by-country reporting (also part of Action 13) from January 2017 onwards.[6] Among OECD members that have closer economic connections with Hong Kong, Australia has implemented or been implementing the most BEPS actions. The Australian government, for instance, has put forward the Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill in 2013, which is in effect a homemade transfer pricing regime that matches the OECD standard for Actions 8-10.[7] Australia is also one of the first countries – along with countries like New Zealand, Norway, and France – to introduce country-by-country reporting as well as master/local transfer media transfer pricing documentation requirements in accordance with OECD standards for Action 13.[8]

2. **Proposed penalties not strict enough to deter non-compliance:** The Hong Kong government proposes a lump sum fine of HK$100,000 for failure to comply with the requirements that relate to master and local files, as well as failure to submit country-by-country reports without reasonable excuse. In the latter case specifically, continuing offense after conviction for non-compliance may lead to a further fine of HK$500 for each day of offense. Nevertheless, a lump sum penalty

[6] "BEPS Actions implementation by country: Singapore," https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-beps-actions-implementation-singapore.pdf

[7] "Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013," http://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/Bills_Search_Results/Result?bId=r4965

[8] "BEPS Action 13: Country Implementation Summary," http://www.kpmg-institutes.com/content/dam/kpmg/taxwatch/pdf/2016/beps-action-13-country-implementation-summary.pdf

may seem less and less a deterrent in cases where the amount of tax evaded by corporate taxpayers is substantial and intentional. This is compared to Australia, where a per unit penalty is imposed. The Australian Taxation Office charges a penalty of 25 per cent of the tax shortfall on corporate taxpayers who do not prepare transfer pricing documentation and do not have a reconciliation action plan. They may also charge a maximum penalty of 50 per cent of the tax shortfall if non-compliance is found to be solely for the purpose of tax evasion.[9] In Finland, failure to submit transfer pricing documentation in a timely manner may result in a tax penalty of a maximum of €25,000 (HK$206,773). Further penalties may be imposed after an additional assessment is made; an administrative fine may amount to up to 40 per cent of the increase of the taxable income.[10] In Germany, for the late submission of transfer pricing documentation, a penalty of a maximum of €1 million (HK$8.27 million), with a minimum of €100 (HK$827) for each day after the 30- or 60-day limit is exceeded, may be imposed.[11]

3. **Reluctance to enter multilateral agreements on tax-related information exchange:** The MCMAA was developed by the OECD and Council of Europe in 1988 as the most comprehensive multilateral instrument available for all forms of tax cooperation to tackle tax evasion and avoidance. Its amended version in 2010 provides for all possible forms of administrative cooperation between states in the assessment and collection of taxes, in particular with a view to combat tax avoidance and evasion. Such international cooperation includes the automatic exchange of information and the recovery of foreign tax claims.[12] As of November 2016, a total of 107 OECD and non-OECD tax jurisdictions – including mainland China, India, Indonesia, and Singapore – have entered the Convention. Even small tax jurisdictions such as the British Virgin Islands, Cayman Islands, Guernsey, and Jersey have entered the Convention as an extension of the United Kingdom.[13] Should the Hong Kong government intend to demonstrate its commitment to combat cross-border tax avoidance and tax evasion, it should not avoid entering the MCMAA, although high standards on

---

9 "Australia: Final ATO guidance on transfer pricing documentation and penalties," https://www.pwc.com/gx/en/tax/newsletters/pricing-knowledge-network/assets/pwc-australia-final-tp-documentation-guidance.pdf

10 "Finland," http://www.pwc.com/gx/en/international-transfer-pricing/assets/finland.pdf

11 "Germany," http://www.pwc.com/gx/en/international-transfer-pricing/assets/germany.pdf

12 "Convention on Mutual Administrative Assistance in Tax Matters," http://www.oecd.org/tax/exchange-of-tax-information/convention-on-mutual-administrative-assistance-in-tax-matters.htm

13 "Jurisdictions Participating in the Convention on Mutual Administrative Assistance in Tax Matters Status – 21 November 2016," http://www.oecd.org/tax/exchange-of-tax-information/Status_of_convention.pdf

confidentiality and data protection are necessary upon joining it.

4. **Absence of intention to publicise country-by-country reports:** In the Paper, the Hong Kong government has not stated whether it recommends country-by-country reports to be open to public access. As a matter of fact, the European Commission has maintained that country-by-country reports should be made available for public scrutiny of whether tax is paid where profits are produced, in addition to being made available for tax authorities to identify potentially harmful tax practices.[14] In September 2016, the British Parliament has also approved a Finance Bill amendment that requires country-by-country reports be made public.[15] After all, since its inception, country-by-country reporting is meant to require multinational corporations to disclose financial details about their operations in every nation.[16] If the Hong Kong Government is committed to implementing the BEPS action of country-by-country reporting, it has to require that these reports are made public, as long as the benefits from such requirements are balanced with the potential compromise of taxpayers' privacy.

5. **No mention of what needs to be included in country-by-country reports:** In its guidance on country-by-country reporting, the OECD recommends national governments to include in their draft laws a clause that requires multinational corporations to report 'aggregate information relating to the amount of revenue, profit (loss) before income tax, income tax paid, income tax accrued, stated capital, accumulated earnings, number of employees, and tangible assets other than cash or cash equivalents with regard to each jurisdiction' where the corporation operates, as well as 'the nature of the main business activities' of the corporation's different constituents around the world.[17] Had the Hong Kong government been committed to the implementation of BEPS Action 13, it would have clearly stated in the Paper what it expects multinational corporations to report about their operations in different countries.

6. **Absence of intention to exchange beneficial ownership information:** The Hong

[14] "Country-by-country reporting: An EU perspective," https://home.kpmg.com/content/dam/kpmg/pdf/2016/08/eu-tax-centre-cbcr-an-eu-perspective.pdf
[15] "U.K. opts for public country-by-country reporting," https://www.bloomberg.com/professional/blog/u-k-opts-public-country-country-reporting/
[16] "UK moves forward on Country by Country reporting," http://www.taxjustice.net/2016/09/06/uk-moves-forward-country-country-reporting/
[17] "Action 13: Country-by-Country Reporting Implementation Package," https://www.oecd.org/ctp/transfer-pricing/beps-action-13-country-by-country-reporting-implementation-package.pdf

Kong government has not made any commitment to adopt a mandatory disclosure programme regarding aggressive tax planning schemes. On the other hand, Portugal is an OECD member that has implemented anti-aggressive tax planning rules in its tax code with specific reference to beneficial ownership.[18] While there is currently no law in Hong Kong making disclosure of beneficial ownership mandatory – beneficial ownership is also not directly addressed in the BEPS initiative – the Hong Kong Government should aim to implement BEPS Action 12 with mandatory disclosure of information relating to beneficial ownership of multinational corporations.

Oxfam's Recommendations

Competition between governments in every part of the world to offer more favourable tax regimes to global corporations and the super-rich is damaging their own economies, those of other countries, and is not in the public interest. Tax revenues are needed to fund public goods and services, which contribute to the development of social and economic infrastructure. Most countries raise revenues by taxing both capital and labour. Tax competition among countries and the growth in the use of tax havens has meant that states find it increasingly difficult to tax income from capital. Consequently, either tax revenues decline or the burden of tax shifts more heavily onto labour. Ultimately, the negative effects are felt most by the public, especially the poor, who are faced with the triple impact of a higher tax burden, declining public goods and services, and having to subsidise corporate and private wealth.

Tax havens are the ultimate expression of the global corporate tax race to the bottom, and they can be found in any part of the world. As the Panama Papers have shown, Hong Kong has often been used by multinational corporations and super rich individuals alike as an intermediary to shift profits to some of the world's most aggressive tax havens such as the Cayman Islands and Bermuda. Indeed, Oxfam's latest report ranks **Hong Kong as the ninth 'worst corporate tax haven' in the world, given substantial evidence of large scale profit shifting here.**[19] Oxfam believes that tax transparency is the key to tax justice Oxfam welcomes the Hong

[18] "CFE GAAR Survey: Anti-Abuse and Aggressive Tax Planning Rules in European Countries (2016 update)," http://www.cfe-eutax.org/sites/default/files/CFE%20Anti%20Abuse%20and%20Aggressive%20Tax%20Planning%20Survey%20update%202016%20final%2015-2-2016.pdf; "Code of Taxation of Income and Gains of Collective Persons," http://info.portaldasfinancas.gov.pt/NR/rdonlyres/1AACA56C-F792-4E0A-97A1-E85CCF72FF03/0/Bilingual_Code_Taxation_IRC.pdf

[19] "Tax Battles"

Kong government's commitment to tax transparency; however, based on its analysis above, various inadequacies were found in the proposal to implement the OECD's BEPS package. The Hong Kong government will need to address these in order to show that its commitment to fighting tax avoidance and tax evasion is genuine.

We recommend that the Hong Kong government take the following actions regarding BEPS implementation:

1. **Implement all BEPS actions applicable to Hong Kong – not only actions that are minimum standards or only what it considers as current priorities – on a clear timeline and by the end of financial year 2017-2018.**
2. **Design more deterrent and effective penalties for non-compliance with transfer pricing documentation requirements.**
3. **Enter multilateral agreements like MCMAA to facilitate the freer exchange of information with other jurisdictions to combat cross-border tax evasion and tax avoidance more effectively, given that high standards of confidentiality and data protection are adhered to.**
4. **Require that multinational corporations' country-by-country reports are made available for public scrutiny, given that the potential risk to taxpayers' confidentiality has been taken into account.**
5. **Improve public tax transparency by requiring all multinational companies to publish country-by-country reports. Reports should have separate data for each country in which they operate, including the breakdown of their turnover, intra-firm sales, employees, physical assets, profits and current taxes due and taxes paid.**
6. **Require multinational corporations to disclose their beneficial ownership as part of the AEOI mechanism.**

Appendix 1: BEPS Implementation in Hong Kong and Other Tax Jurisdictions[20]

		1	2	3	4	5	6	7	8,9,10	11	12	13a	13b	14	15
OECD	Australia	○	○	※	※	○	○	●	●			●	●		
	Austria	●				●						●	●		
	Belgium	●	○	○	○	●	●		●			●	●		
	Canada	※	※	※	※	※			○		※	※	●		
	Chile	●		●	●	●	●		●		●	●	●		
	Czech Republic	●	○	○	○	○			○				○		
	Denmark	●	※	※	※	※	※	※	※			●	●		
	Estonia	●	●	○			○		○			○	○		
	Finland	●	●						○			○	○		
	France	●	●	※			○	○	●			○	●		
	Germany	●	○	○	○	※	○					○	○		
	Greece	●	●			●									
	Hungary	●				●			○						
	Iceland														
	Ireland	●		○	○	●						●	●		
	Israel						●				●	○	○		
	Italy	●	●	※		●	●							●	
	Japan	●	●			※	○					○	●	○	
	South Korea	●		※	●		※					●	●		
	Luxembourg	●	●												
	Mexico		●				●				●	●	●		
	Netherlands	●	●	○		○			※		※	●	●		
	New Zealand	●		※		●					※		●		
	Norway	※	●		●				※				○		
	Poland	●	●	●	●				○			○	○		
	Portugal	●	●	※	※	○					●		●		
	Slovakia	●	●		●	●						●			
	Slovenia	●	●												
	Spain	●	●	●	●	●			●			●	●		
	Sweden	●	●		●	※			※			○	○		
	Switzerland		※	※	※	○			●		※	※	○		
	Turkey	●		※				○	○			○	○		
	United Kingdom	●	○	※	○	●			●		※	※	●		
	United States	※	※	※	※	※		※	※		※	※	●		
Non-OECD	Argentina	●													
	Brazil		●	●	●	●			※			※	●		
	China	※		○	※	○	○	○						○	
	Hong Kong			※						※					
	India	●				●	○						○		
	Indonesia				●		※					●			
	Russia	○			※	※	※	※			○	○	○		
	Saudi Arabia	※													
	Singapore					※						●	○		
	South Africa										○	○	●		

Legend	
●	Implemented
○	In progress / to be implemented
※	Not applicable

Note: Information updated between August and November 2016

[20] "BEPS Actions Implementation Matrices," https://www2.deloitte.com/global/en/pages/tax/articles/beps-action-implementation-matrices.html

Appendix 2: BEPS Actions[21]

1	Addressing the tax challenges of the digital economy
2	Neutralising the effects of hybrid mismatch arrangements
3	Designing effective CFC rules
4	Limiting base erosion involving interest deductions and other financial payments
5	Countering harmful tax practices more effectively, taking into account transparency and substance
6	Preventing the granting of treaty benefits inappropriate circumstances
7	Preventing the artificial avoidance of permanent establishment status
8-10	Aligning transfer pricing outcomes with value creation
11	Measuring and monitoring BEPS
12	Mandatory disclosure rules
13a	Transfer pricing documentation
13b	Country-by-country reporting
14	Making dispute resolution mechanisms more effective
15	Developing a multilateral instrument to modify bilateral tax treaties

[21] "BEPS Actions," http://www.oecd.org/ctp/beps-actions.htm