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By email: RGCITDTaxTreatiesBranch@treasury.gov.au

Expanding Australia's Tax Treaty Network to Include Hong Kong

Dear Ms Ram

The Government will expand Australia's tax treaty network with 10 new and updated Double Taxation Treaties (DTTs) by 2023. EY welcomes the announcement by the Treasurer¹ on 15 September 2021 and the Treasury's subsequent invitation to comment².

We understood Treasury in its consultation that closed on 31 October 2021 had sought technical input on treaty policy only, not comments on Australia's treaty priorities. Please allow us to share some of our concerns should Hong Kong not be part of the four remaining jurisdictions with treaty negotiations progressing outside the core consultation process.

We believe this is so important as to warrant a rethink of the Government priorities and we urge Treasury, as the principal adviser to Government, to bring this to the Government's attention and suggest expanding the list of jurisdictions to include Hong Kong.

Following the October 2020 Federal Budget announcement of upcoming action, six jurisdictions were listed the Treasurer's media release³ for treaty negotiations in 2021 and 2022. We appreciate negotiations with India, Luxembourg and Iceland are occurring this year as part of the first phase of the program. Negotiations with Greece, Portugal and Slovenia are scheduled to occur next year as part of the second phase.

India is the only major trading partner in our region to be listed for an updated treaty. The other jurisdictions are members of the European Union (EU) likely priorities as part of the Australia-EU Free Trade Agreement (FTA) negotiations. Luxembourg is both a member of the EU and financial services centre.

Hong Kong is an important trading partner and source of FDI for Australia, is a key financial services centre, recently concluded an FTA and a tax information exchange agreement (TIEA) with Australia but yet is left without a DTT. We submit the next wave of focus must be on our trading partners in Asia.

The purpose of writing to you now is to express our concern if Hong Kong were left off the list it may take years before capacity becomes available to engage in further negotiations for new DTTs.

¹ [Expanding Australia's tax treaty network to cover 80 per cent of foreign investment | Treasury Ministers](#), 15 September 2021

² [Expanding Australia's Tax Treaty Network | Treasury.gov.au](#), 16 September 2021

³ [Expanding Australia's tax treaty network to cover 80 per cent of foreign investment | Treasury Ministers](#), 15 September 2021

As the (then) Minister for Trade, Tourism, and Investment Simon Birmingham,⁴ DFATs NIA,⁵ and the Joint Standing Committee on Treaties outlined, our trade relationship with Hong Kong is incredibly important. The following statistics from the Department of Foreign Affairs and Trading's (DFATs) website confirm this:

- ▶ Hong Kong is our 15th largest two-way trading partner
- ▶ Two-way trade in goods and services was valued at \$12.2b in 2020 – Comprising 1.5% of our total two-way trade
- ▶ Hong Kong is our 10th biggest export market
- ▶ Australia exported \$8.771b in 2020 – Comprising 2% of our total exports
- ▶ Hong Kong invested \$141.6b into Australia in 2020 – Our 5th largest foreign investor⁶
- ▶ This amounts to 3.5% of total foreign investment into Australia in 2020
- ▶ Foreign investment comprises direct, portfolio investment and other investment
- ▶ Australia invested \$71.1b into Hong Kong in 2020 – Our 8th largest investment destination⁷

A number of the other jurisdictions which have been prioritised for Treaty negotiations do not approach anywhere near the strength and importance of a trading relationship, or indeed a cultural relationship, that we have with Hong Kong.

We also intend for this submission to amplify the importance of establishing a DTT with Hong Kong also against the ambition to establish Australia as a financial services centre in Asia Pacific

The Australia as a Financial & Technology Centre Advisory Group (AFTCAG) Report⁸ in January 2021, "Making Australia an internationally competitive financial centre & attracting Asia-Pacific business headquarters to Australia", observed:

"The Australian financial services sector has historically been very domestically focused and has not promoted itself effectively globally and in our region. The Committee has noted that Australia has, for example, not appeared on many lists of alternate financial centres being presented to companies in Hong Kong that are considering moving, in part due to outdated and incomplete perceptions of Australia."

We believe Australia has a good story to tell. The time to act is now as businesses from Hong Kong expand their footprint overseas and the world is moving towards a new international tax framework.

The AFTCAG final report recommended introducing a Days-in Days-out (DIDO) system for taxing senior staff/entrepreneurs running Regional or Global businesses. The establishment of an Incremental Business Activity Rate (IBAR) regime offering tax rebates for up to 7 years to companies establishing a "Qualifying Business" in Australia. We contrast against this in the appendix to this letter, how the tax settings between Hong Kong are lacking the most rudimentary foundations due to the absence of a DTT.

The Treasurer's media release states, "tax treaties improve tax system integrity through the establishment of a bilateral framework of cooperation on the prevention of tax evasion, the collection of

⁴ [Australia's free trade deal with Hong Kong commences | Minister for Trade, Tourism and Investment \(trademinister.gov.au\)](https://www.minister.gov.au/ministers/simon-birmingham/media-releases/2020/01/16/australia-free-trade-deal-hong-kong-commences)

⁵ National Interest Analysis [a-hkfta-national-interest-analysis.pdf \(dfat.gov.au\)](https://www.dfat.gov.au/australia-as-a-financial-technology-centre/nia)

⁶ [Statistics on who invests in Australia | Australian Government Department of Foreign Affairs and Trade \(dfat.gov.au\)](https://www.dfat.gov.au/australia-as-a-financial-technology-centre/statistics-on-who-invests-in-australia)

⁷ [Statistics on where Australia invests | Australian Government Department of Foreign Affairs and Trade \(dfat.gov.au\)](https://www.dfat.gov.au/australia-as-a-financial-technology-centre/statistics-on-where-australia-invests)

⁸ AFTCAG Report, Making Australia an internationally competitive financial centre & attracting Asia-Pacific business headquarters to Australia, January 2021– [link](#), page 11

tax debts and rules to address tax avoidance”.⁹ This manifests the important role DTTs play in protecting the integrity of the tax system complemented by reducing barriers to investment and trade, increasing certainty, and reducing compliance cost.

New Zealand concluded a DTT and free trade agreement (FTA) with Hong Kong to further tighten an important trading relationship. The DTT was updated in 2018 to include a tax information article in line with global standards.¹⁰ Before the update via information was only exchanged on request.

The Australia-Hong Kong Free Trade Agreement (A-HKFTA) entered into force on 17 January 2020 and a tax information exchange agreement (TIEA) with Hong Kong commenced on 1 July 2021:

- ▶ The Senate Joint Standing Committee on Treaties¹¹ found it was in Australia’s national interest stating the advantages of the agreement have not been questioned whilst acknowledging it coincided with an uncertain political situation:
 - ▶ Hong Kong is already an open market but the A-HKFTA will lock in existing zero tariffs and address some non-tariff barriers.
 - ▶ The Australia-Hong Kong investment treaty will replace an outdated bilateral investment treaty and provide certainty
 - ▶ Hong Kong is one of Australia’s most significant trading partners
 - ▶ A-HKFTA and the Investment Agreement will strengthen this economic relationship – sets up a framework for future engagement
 - ▶ The A-HKFTA guaranteed present levels of openness into the future
 - ▶ Mitigates future risk
- ▶ The A-HKFTA and the Investment Agreement reaffirm the value Australia places on the high degree of autonomy enjoyed by Hong Kong through the “One Country, Two Systems” framework.¹²
- ▶ The recent TIEA with Hong Kong enhances Australia’s position as a financial services hub in Asia Pacific. The TIEA with Hong Kong took effect from 1 July 2021 and provides a strong foundation for DTT addressing further integrity concerns.

Hong Kong has an extensive treaty network including with G20 jurisdictions: Canada, the UK, France, Japan, Mainland China, Italy, South Africa, Switzerland, Mexico, India and Indonesia.

The tax settings between Hong Kong and Australia specifically lack rudimentary bilateral rules and guidance around:

- ▶ Anti-abuse and prevention of non-taxation rules
- ▶ Certainty and tiebreaker provisions dealing with tax residency of individuals
- ▶ Bilateral guidance for permanent establishments with important integrity provisions
- ▶ Rules for income from immovable property, business profits and alienation of property
- ▶ Relief from double taxation: credits for withholding taxes and reduced rates
- ▶ Corresponding Transfer Pricing Adjustments
- ▶ Limitation on benefits
- ▶ Mutual agreement procedures

⁹ [Expanding Australia’s tax treaty network to cover 80 per cent of foreign investment | Treasury Ministers](#), 15 September 2021

¹⁰ [Hong Kong DTA updated \(ird.govt.nz\)](#)

¹¹ Joint Standing Committee on Treaties, [Report 186 \(aph.gov.au\)](#)

¹² Australia-Hong Kong Free Trade Agreement and associated Investment Agreement – [DFAT link](#)

► Non-discrimination

Our detailed comments are set out in the Appendix A.

In conclusion, we believe a DTT with Hong Kong is very much in Australia's interest. We understand the business community and the various Australia/HK trade associations that represent it are very much in favour of such a DTT being negotiated. We understand that Hong Kong as a Special Administrative Region of Mainland China is also amenable to such.

Accordingly, as noted earlier, we believe this is so important that we urge Treasury, as the principal adviser to Government, to bring this to the Government's attention and suggest expanding the list of jurisdictions to include Hong Kong.

If you have any queries or would like to discuss this submission please contact Antoinette Elias or Alf Capito at EY Sydney office on 02 9248 5555.

Yours sincerely



Antoinette Elias
Partner



Alf Capito
Director Tax Policy

Attachment

Appendix : Tax settings with Hong Kong lack rudimentary foundations

It is in Australia's national interest to conclude DTTs to reduce barriers to investment and trade by removing barriers for businesses undertaking business activities in both jurisdictions. In particular, Australian business should be more easily able to access investment and intellectual property as a result of reduced withholding tax rates. Taxpayers enjoy increased certainty and reduced compliance costs taxpayers. And DTTs establish a more effective framework to prevent international fiscal evasion and avoidance.¹³

Without a DTT the bilateral tax rules between Hong Kong lack the following fundamental features around anti-abuse and prevention of non-taxation as well as relief for and prevention of double taxation:

- ▶ Certainty and tiebreaker provisions dealing with tax residency of individuals
- ▶ Taxes covered include income tax, fringe benefits tax and resource rent taxes
- ▶ Treaty benefits allowed for income derived by or through fiscally transparent entities
- ▶ 'Permanent establishment' definition including important integrity provisions and attribution of profits
- ▶ Ability to tax income derived from the use of immovable property, including mining rights
- ▶ Rules for profits from international shipping and air transport operations
- ▶ A seven-year time for transfer pricing adjustments, with correlative adjustments
- ▶ Source country taxation limited to reduced rates on dividends, interest, and royalties
- ▶ Comprehensive rules to govern the allocation of taxing rights
- ▶ Pensions plus remuneration derived by teachers, professors, and researchers
- ▶ Income not expressly dealt with elsewhere in the treaty may be taxed by both jurisdictions.
- ▶ Limitation of benefits, non-discrimination, and mutual agreement rules

1. Certainty and tiebreaker provisions dealing with tax residency of individuals

Lack of certainty and tax risk is a major disincentive to individuals working in Australia and in the context of the current skills shortage, this puts Australia at a significant competitive disadvantage.

Undertaking an exchange or secondment of employees for periods of less than two years, may give rise to a potential double income-taxation liability with no treaty tie breaker protection. This can also occur in longer term arrangements where the employee maintains strong ties with Australia.

Australia can evoke source taxation from day one. Engagements that may exceed the 60 days would be captured under the Hong Kong income tax laws.

Furthermore, law changes proposed in Australia create new issues for exchange or secondment for periods of less than two years:

¹³ The National Interest Analysis (NIA) in March 2019 number of reasons as to why Australia should enter into a tax treaty with Israel (A-I Tax Convention - [Treasury Laws Amendment \(International Tax Agreements\) Bill 2019 – Parliament of Australia \(aph.gov.au\)](https://aph.gov.au))

The Government in response to Board of Taxation recommendations¹⁴ announced in the May 2021 Federal Budget¹⁵ it will replace the individual tax residency rules with a new, modernised framework. The measure will have effect from the first income year after the date of Royal Assent of the enabling legislation.

- ▶ The primary test will be a 'bright line' test: a person who is physically present in Australia for 183 days or more in any income year will be an Australian tax resident.
- ▶ Individuals who do not meet the primary test will be subject to secondary tests that depend on a combination of physical presence and measurable, objective criteria.

The Budget didn't include details of the secondary test but if the Board of Taxation recommendations are followed, it will include a 45-day test. That is, while the primary test is 183 days, the days count drops to 45 days for former Australian residents for the three years following departure. Not only that, but someone moving of their own choice would need to reach three years of less than 45 days per year to break residence, as opposed to becoming non-resident on departure and preserving that by staying out for under 45 days (see example 11 in the BoT paper¹⁶). Being an Australian citizen or permanent resident immediately meets one of the two accompanying factor tests, so having access to accommodation, immediate family remaining in Australia or significant economic connections is enough to preserve residence.

The test is different for assignees on secondments of more than two years but still requires less than 45 days in Australia for each year of secondment to the foreign country.

Regarding DTT overlay, it might start to become problematic to seek tie-breaker relief for an Australian citizen with one or two of the other factors (i.e., the treaty is likely to treat them as Australian resident also). But at least if tie-breaker relief does apply then they will be deemed non-resident.

2. Bilateral guidance for permanent establishments

DTTs generally provide that the business profits of a foreign enterprise are taxable in a jurisdiction only to the extent that the enterprise has in that jurisdiction a permanent establishment to which the profits are attributable. The definition of permanent establishment included in tax treaties is therefore crucial in determining whether a non-resident enterprise must pay income tax in another jurisdiction.

Without bilateral alignment under DTTs granting taxing rights to one country only, double taxation can arise. Furthermore, the revised permanent establishment definition under the OECD BEPS Action plan counteracts common tax avoidance strategies used to circumvent permanent presence.

3. Credits for withholding taxes and reduced rates

Hong Kong is [a] distinct priority, as a major financial services centre with which Australia, with our ambitions to become a financial hub, should have integration featuring low withholding taxes and other impediments to Australia's financial hub ambitions.

¹⁴ [Reforming Individual Tax Residency Rules – A Model for Modernisation | Board of Taxation \(taxboard.gov.au\)](#)

¹⁵ [Budget Paper No. 2 | Budget 2021-22](#)

¹⁶ [Reforming Individual Tax Residency Rules – A Model for Modernisation | Board of Taxation \(taxboard.gov.au\)](#)

In Senator Bragg's AFTCAG Report, it is argued that interest withholding tax on borrowings

"The imposition of IWT in Australia is a barrier to Australia becoming a leading financial centre. IWT is levied on interest paid by an Australian resident payer (including branches) to a non-resident payee. The Australian resident payer must withhold 10% for interest payments, unless exempted by the ITAA 1936 or reduced by Australia's double tax agreements.

Establishing a DTT with Hong Kong will help remove this barrier.

4. Corresponding Transfer Pricing Adjustments

Hong Kong allows corresponding transfer pricing adjustments only under DTTs.

Under DTTs a seven-year time limit will generally apply for making transfer pricing adjustments, with a correlative adjustment to be made to the profits of an associated enterprise so that the transfer pricing adjustment does not result in double taxation of the same profits in the hands of two associated enterprises.

Hong Kong is a BEPS Associate jurisdiction and the Transfer Pricing framework is largely based on the OECD Guidelines, and the IRD generally will not differ from the TP methodologies recommended by the OECD Guidelines.¹⁷

Mutual Agreement Procedure (MAP) exist in the DTTs of both Hong Kong and Australia under which the transfer pricing adjustment made to the income of a company resident in the other country can be deemed to be at arm's length, with the double taxation eliminated by making a corresponding adjustment. MAP should be initiated within the time limit from the first notification of the actions giving rise to taxation not in accordance with the provisions of the DTT.

5. Implementation of OECD Pillar 1 and 2

Modern DTTs directly incorporate a number of Base Erosion and Profit Shifting (BEPS) recommendations, including rules to prevent treaty shopping and to facilitate greater co-operation between tax authorities.

On 8 October 2021 the OECD released a statement reflecting the agreement reached by 136 out of the 140 Inclusive Framework members on core design features of the two-pillar solution developed in the BEPS 2.0 project:

- ▶ Pillar One on revisions to nexus and profit allocation rules
- ▶ Pillar Two on new global rules that seek to introduce a minimum tax

The amount of residual profit to be re-allocated to market jurisdictions under Pillar One has been set at 25% and the rate for the minimum tax under Pillar Two has been agreed at 15%.

According to the plan for Pillar One, Amount A will be implemented through an MLC, regardless of whether a tax treaty currently exists, although this remains to be finally determined subject to finalisation of the relevant rules.

¹⁷ [Worldwide Transfer Pricing Reference Guide 2019-20 | EY - Global](#)



Pillar Two model rules and accompanying commentary will be developed by the end of November 2021. A model treaty provision to give effect to the STTR also will be developed by the end of November 2021. An MLI will be developed by the Inclusive Framework by mid-2022 to facilitate the implementation of the STTR in bilateral tax treaties (emphasis added). The model treaty provision will be supplemented by commentary that explains the purpose and the operation of the STTR. A process to assist in implementing the STTR will be agreed. By the end of 2022 at the latest, an implementation framework will be developed to facilitate the implementation of the GloBE rules.