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Panel on Financial Affairs

Meeting on 3 November 2014

**Background brief on automatic exchange of
financial account information in tax matters**

Purpose

This paper provides background information on automatic exchange of information for tax purposes. It also summarizes the views and concerns expressed by Members when issues related to exchange of tax information ("EoI") under comprehensive agreements for avoidance of double taxation ("CDTAs") and tax information exchange agreements ("TIEAs") were discussed by the committees of the Legislative Council ("LegCo") in 2009 to 2014.

Policy on EoI arrangements

2. It has been the Government's policy priority to conclude CDTAs with Hong Kong's trading and investment partners which serve as a business facilitation initiative to minimize the incidence of double taxation¹. Thus, CDTAs facilitate the flow of trade, investment and talent between Hong Kong and the rest of the world, as well as enhance Hong Kong's position as an international business and financial centre. All CDTAs signed embody a mechanism for EoI up to the international standard as far as practicable.

3. According to the Global Forum on Transparency and Exchange of Information for Tax Purposes ("Global Forum")² of the Organization for Economic Cooperation and Development ("OECD"), a jurisdiction should make available both CDTA and TIEA as instruments for EoI with other jurisdictions. A TIEA is a form of agreement for EoI which carries no double taxation relief. The Inland Revenue (Amendment) (No. 2) Ordinance 2013 was enacted by

¹ Double taxation is generally defined as the imposition of comparable taxes in two or more places on the same taxpayers in respect of the same subject matter for identical periods.

² The Global Forum consists of some 120 member jurisdictions including Hong Kong.

LegCo at the meeting of 10 July 2013. The Amendment Ordinance has put in place a legal framework for Hong Kong to enter into standalone TIEAs with other jurisdictions and enhanced EoI arrangements in respect of tax types and limitation on disclosure under CDTAs³. On 25 March 2014, Hong Kong concluded its first TIEA with the United States.

EoI mechanism under CDTAs/TIEAs

4. The existing legal framework of Hong Kong only allows for information exchange upon requests under either CDTAs or TIEAs. The EoI regime and related safeguards in Hong Kong are provided in the Inland Revenue Ordinance (Cap. 112), the Inland Revenue (Disclosure of Information) Rules (Cap. 112 sub leg BI) ("the Disclosure Rules")⁴ and the relevant Orders implementing individual CDTAs/TIEAs. These safeguards are generally based on the 2004 version of the EoI Article in the OECD Model Tax Convention on Income and on Capital, and the OECD 2002 version of TIEA model, except for certain modifications to address local needs. A number of safeguard measures are included in CDTAs/TIEAs to protect taxpayers' privacy and confidentiality of information exchanged.

Recent development in international EoI standard – automatic exchange of information

5. According to the Administration, for the purpose of enhancing tax transparency and combating cross-border tax evasion, the OECD released a Common Reporting Standard for Automatic Exchange of Financial Account Information in Tax Matters in July 2014 calling on governments to obtain detailed account information from their financial institutions and exchange that information automatically with jurisdictions of residence of account holders on an annual basis. The Global Forum has invited all its members including Hong Kong to commit to implementing the new global standard on automatic EoI. Over 65 jurisdictions have publicly committed to the implementation.

6. On 15 September 2014, the Administration indicated to the Global Forum Hong Kong's support for the new global standard on automatic EoI. The Administration will engage relevant stakeholders and address relevant policy and legal issues involved, with a view to drawing up detailed legislative

³ The Inland Revenue (Amendment) Bill 2013 was enacted as the Inland Revenue (Amendment) (No.2) Ordinance 2013. The Amendment Ordinance has relaxed the coverage of tax types for the purpose of EoI under CDTAs/TIEAs to the effect that EoI will no longer be restricted to income taxes.

⁴ The Disclosure Rules stipulate the particulars to be contained in an EoI request made by an overseas jurisdiction to demonstrate that the requested information is "foreseeably relevant". It also provides for a notification and review system in handling EoI requests and related appeals.

proposals and seeking LegCo's approval to implement the new global standard. According to the latest timeline allowable by the Global Forum, the first automatic information exchanges are to commence by the end of 2018. It is the Administration's plan to introduce the relevant legislative proposals into LegCo in January 2016.

Concerns and views expressed by Members

7. Issues relating to the operation of the EoI mechanism were discussed at meetings of the Panel on Financial Affairs and other relevant committees in 2009, 2012, 2013 and 2014, including during the scrutiny of the Inland Revenue (Amendment) Bill 2013, the three Orders made under section 49(1A) of IRO and gazetted on 4 October 2013 to implement the CDTAs entered between Hong Kong and Guernsey, Italy and Qatar respectively, and the Inland Revenue (Exchange of Information relating to Taxes) (United States of America) Order. The major views and concerns expressed by Members on related issues are summarized in the ensuing paragraphs.

Benefits of tax information exchange

8. Some Members queried the benefits of tax information exchange under TIEAs. These Members expressed concern that TIEAs would not bring double taxation relief for Hong Kong but involve the provision of confidential information of taxpayers to other tax jurisdictions. They pointed out that in view of the territorial source principle of taxation adopted in Hong Kong, there would be limited financial benefits for Hong Kong arising from any crackdown on tax evasion cases by way of EoI. There would be burden on Hong Kong taxpayers in respect of retention and reporting of tax information.

9. The Administration stressed that it was essential for Hong Kong to keep up with the prevailing international EoI standard and provide the relevant legal framework, otherwise it might run the risk of being labelled as an uncooperative jurisdiction, which in turn would undermine its position and competitiveness as an international business and financial centre. The Administration emphasized that it would only disclose the relevant information requested according to the EoI provisions and the laws of Hong Kong, and would not make any investigation or take enforcement actions on behalf of tax authorities of other jurisdictions.

Scope of information disclosure and privacy protection

10. Regarding Members' concern about the scope of information disclosure under EoI mechanism and whether the disclosure coverage could be limited by mutual agreement between the jurisdictions concerned, the Administration

explained that as OECD had developed relevant model agreements, there was limited room for individual jurisdictions to make adjustments to the scope of EoI. Any major deviations from the model agreement would run the risk that the relevant agreement was not a compliant EoI agreement.

11. Some Members expressed concern that the existing EoI mechanism might lead to compulsory disclosure of information generated longer than the existing requirement on taxpayers to retain business records for seven years under sections 51C and 51D of IRO. They considered that the Administration should consider restricting disclosure of information to that generated within seven years prior to the effective date of the relevant EoI agreement.

12. The Administration explained that when conducting EoI, it had all along adopted a policy of imposing a limitation on the information to be exchanged, i.e. the information disclosed must relate to the carrying out of the provisions of the relevant CDTAs/TIEAs or the administration/enforcement of the tax laws of the treaty partner concerning taxes imposed in the periods after the provisions of the CDTAs/TIEAs came into effect. In respect of the concern about burden on taxpayers in the retention of records to beyond seven years, the Administration advised that it had no plan to change the existing record-keeping requirements under sections 51C and 51D of IRO.

13. As regards protection of the confidentiality of the tax information exchanged with another jurisdiction, the Administration advised that the existing Disclosure Rules provided for domestic statutory safeguards in addition to those provided in individual agreements for EoI under CDTAs/TIEAs. The EoI mechanism provided that any information received by a contracting party, including commercial information, should be treated confidential and might be disclosed only to persons or authorities (including courts and administrative bodies) in the jurisdiction concerned with the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes covered by the agreement; and such persons or authorities should use such information only for such purposes. If treaty partners were considered to have violated their obligations, including the confidentiality requirements, Hong Kong would, where warranted, take necessary action against the treaty partner in question, including termination of the relevant agreement.

Strategies for pursuing CDTAs and review of CDTAs and TIEAs

14. Some Members opined that the Administration should uphold its policy of giving greater priority to negotiation of a CDTA than a TIEA and only consider signing a TIEA when concluding a CDTA was not an option. The Administration responded that given the benefits of CDTAs, it would remain a policy priority to seek to conclude CDTAs with Hong Kong's trading and

investment partners. As it was the international standard that preference for CDTA over TIEA could not be a reason for refusing to enter into an EoI agreement, while the Administration would continue its efforts in persuading trading and investment partners to pursue CDTAs with Hong Kong, it could not preclude the possibility of entering into TIEAs but not CDTAs with some jurisdictions.

15. The Administration was requested to conduct regular reviews of the CDTAs/TIEAs that Hong Kong had entered/would enter into in order to ensure Hong Kong taxpayers' interests were not adversely affected by the agreements. The Administration advised that IRD would keep under constant review the relevant agreements and stood ready to raise with the competent authorities of the CDTA/TIEA partners any particular issues arising from the implementation of the agreements.

Latest development

16. The Administration will brief the Panel at the meeting on 3 November 2014 on the latest international development in enhancing tax transparency and the Administration's preliminary thinking on how to implement automatic EoI in Hong Kong.

Relevant papers

17. A list of relevant papers is in the **Appendix**.

List of relevant papers

Date	Event	Papers/Minutes of meeting
4 May 2009	The Panel on Financial Affairs ("FA Panel") discussed the extension of the network of agreements for avoidance of double taxation	Discussion paper (LC Paper No. CB(1)1408/08-09(03)) Minutes (LC Paper No. CB(1)2092/08-09)
5 November 2012	FA Panel was briefed by the Administration on its policy regarding the exchange of tax information with other jurisdictions	Administration's paper (LC Paper No. CB(1)91/12-13(04)) Minutes (LC Paper No. CB(1)359/12-13)
4 February 2013	FA Panel was briefed by the Administration on the detailed legislative proposals to enhance the exchange of information arrangements for tax purposes	Administration's paper (LC Paper No. CB(1)484/12-13(05)) Minutes (LC Paper No. CB(1)930/12-13)
10 July 2013	The Legislative Council passed the Inland Revenue (Amendment) Bill 2013	Hansard Report of the Bills Committee (LC Paper No. CB(1)1426/12-13)
October and November 2013	The relevant subcommittee studied the three Orders made under section 49(1A) of the Inland Revenue Ordinance and gazetted on 4 October 2013 for implementing the comprehensive agreements for avoidance of double taxation entered between Hong Kong and Guernsey, Italy and Qatar	Report of the subcommittee (LC Paper No. CB(1)350/13-14)

Date	Event	Papers/Minutes of meeting
May 2014	The relevant subcommittee studied the Inland Revenue (Exchange of Information relating to Taxes) (United States of America) Order	<u>Background brief</u> (LC Paper No. CB(1)1397/13-14(01)) <u>Report of the subcommittee</u> (LC Paper No. CB(1)1601/13-14)
15 September 2014	The Government indicated to the Global Forum on Transparency and Exchange of Information for Tax Purposes Hong Kong's support for the new global standard on automatic exchange of information	<u>Press release issued by the Financial Services and the Treasury Bureau</u>