

For discussion on
6 July 2015

Legislative Council Panel on Financial Affairs

Automatic Exchange of Financial Account Information in Tax Matters

Purpose

The Administration last briefed this Panel in November 2014 on the international development on tax transparency and our preliminary thinking on how to implement the new standard on automatic exchange of financial account information in tax matters (“AEOI”). We launched in April 2015 a consultation exercise to gauge views on how we should apply the new standard in Hong Kong. This paper briefs Members on the proposed policy and legal framework and major views gathered so far during consultation¹.

Hong Kong’s Position on Exchange of Tax Information

2. Exchange of information (“EOI”) for tax purposes is a recognised tool to enhance tax transparency and combat cross-border tax evasion. As a major international financial centre, Hong Kong is committed to following global standards. While Hong Kong practices a simple and territorial-based tax regime, we need to catch up with latest standards to facilitate EOI. Our policy priority is to expand the network of Comprehensive Avoidance of Double Taxation Agreements (“CDTAs”) with major trading and investment partners, while entering into standalone Tax Information Exchange Agreements (“TIEAs”) with jurisdictions if necessary. All 32 CDTAs and seven TIEAs signed² thus

¹ We released a consultation paper on 25 April 2015 and invited views to reach us by 30 June 2015.

² CDTAs signed include Belgium (2003), Thailand (2005), Mainland China (2006), Luxembourg (2007), Vietnam (2008), Brunei, the Netherlands, Indonesia, Hungary, Kuwait, Austria, the United Kingdom, Ireland, Liechtenstein, France, Japan, New Zealand (2010), Portugal, Spain, the Czech Republic, Switzerland, Malta (2011), Jersey, Malaysia, Mexico, Canada (2012), Italy, Guernsey, Qatar (2013), Korea, South Africa and the United Arab Emirates (2014). TIEAs include the United States, Norway, Denmark, Sweden, Iceland, Greenland and Faroe Islands (2014). (*Years of signing in brackets*)

far have embedded an EOI article which meets prevailing international standard.

3. International landscape on tax cooperation has been evolving rapidly. As reported to this Panel in November 2014, the Organisation for Economic Cooperation and Development (“OECD”) released in July 2014 the “Standard for Automatic Exchange of Financial Account Information in Tax Matters”, calling on governments to collect from financial institutions (“FIs”) financial account information of non-domestic tax residents and exchange the information with jurisdictions of residence of account holders on an annual basis.

4. Since the promulgation of the new standard by OECD in July 2014, some 90 jurisdictions, including many key trade and investment partners of Hong Kong, have expressed commitment to the new standard. As a responsible member of the international community and to avoid being labelled as an “uncooperative” jurisdiction which will affect our position as an international financial centre, Hong Kong indicated to the Global Forum on Transparency and Exchange of Information for Tax Purposes (“Global Forum”)³ in September 2014 our support for implementing the new standard on a reciprocal basis with appropriate partners, with a view to commencing the first information exchange by the end of 2018, the latest timeline allowable for implementation. The above commitment was premised on the condition that Hong Kong could put in place necessary domestic legislation by 2017.

What is AEOI?

5. Under the OECD standard⁴, FIs include depository institutions, custodial institutions, insurance companies and investment entities, unless they present a low risk of being used for evading tax and are excluded from reporting.

³ The Global Forum is a widely-represented body consisting of some 120 member jurisdictions including Hong Kong for pursuance of tax transparency agenda.

⁴ Specifically, the AEOI standard comprises -

- (a) Model Competent Authority Agreement (“Model CAA”);
- (b) Common Reporting Standard (“CRS”);
- (c) Commentaries on the Model CAA and CRS; and
- (d) Guidance on Technical Solutions.

FIs are required to identify and keep information of their non-domestic tax resident account holders in accordance with the due diligence procedures prescribed in the OECD standard and report the relevant information of reportable accounts to the tax authority in prescribed format. For account holders who are tax residents of the relevant AEOI partners, the tax authority of the reporting jurisdiction will pass the relevant information to the reportable jurisdictions concerned on an annual basis.

6. In general, a person will be resident for tax purposes in a jurisdiction if he pays or should be paying tax by reasons required under the relevant domestic laws. As tax residence of individual account holders may change from one year to another and the tax laws may differ amongst jurisdictions, individual account holders will have to verify and update their tax residence. The onus is on the individuals to self-certify. FIs will rely on the self-certification of account holders but they should follow specific due diligence requirements in confirming the reasonableness of self-certification.

Proposed Framework for Hong Kong

Policy approach

7. Implementing AEOI requires a fundamental change to our policy and legal framework and to our established position of implementing EOI only on request. In developing the model for Hong Kong, we will adopt a **pragmatic approach** to include the essential requirements of the AEOI standard in our domestic law. We will **ensure effective implementation** of the international standard without creating undue burden of compliance on FIs and the non-Hong Kong tax resident account holders. We intend to conduct AEOI only with our CDTA or TIEA partners on a **bilateral** basis and do not have any plans now to enter into a multilateral treaty with other jurisdictions.

Legal framework

8. Our current thinking is to rely on the bilateral CDTAs or TIEAs signed and having effect by way of Orders made under the Inland Revenue Ordinance (“IRO”) (Cap. 112) as the legal basis for implementing AEOI. The Inland Revenue Department (“IRD”) would still have to sign a new Competent

Authority Agreement (“CAA”), which set out the modalities of transfer of information collected pursuant to the AEOI standard, with the tax authority of CDTA/ TIEA partners concerned.

9. We need to incorporate into our law the essential requirements of the OECD standard, namely key provisions of CAA and due diligence requirements as laid down in Common Reporting Standard (“CRS”), which ensure that AEOI is **effectively implemented** in Hong Kong. Proposed legislative amendments to IRO include -

- (a) definitions of FIs and reportable accounts;
- (b) exemptions in the form of non-reporting FIs and excluded accounts;
- (c) reportable account information, including personal data and financial data of non-Hong Kong tax resident account holders;
- (d) powers of IRD to collect and access to information from FIs; and
- (e) sanctions for FIs for non-compliance and account holders for false self-certification.

Details of current proposed provisions are at **Annex A**.

10. Having regard to the legal framework of the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (“AMLO”) (Cap. 615), we propose to set out the due diligence procedures to be performed by FIs for different types of accounts (i.e. individual and entity; pre-existing and new) in a **Schedule** to IRO. To cater for the need for any future changes and updates, the Schedule may be amended by notice in the Gazette, which is subject to negative vetting by the Legislative Council (“LegCo”).

11. We intend to include in a **Schedule** to IRO the names of the jurisdictions with which Hong Kong has signed a CAA. The Schedule may also be amended by notice in the Gazette, subject to negative vetting by LegCo.

Views Collected

12. Since the launch of consultation in late April, we have so far briefed the Joint Liaison Committee for Taxation, financial institutions' associations, professional bodies, foreign chambers of commerce, and regulatory bodies, etc. (list of bodies and associations at **Annex B**).

13. As gathered from the views expressed so far, there is a general recognition of the need for Hong Kong to catch up with the rapidly evolving international landscape in EOI. While stakeholders have not raised any in-principle objection to the proposed approach for adapting AEOI standard in Hong Kong, they have raised a few key areas of concern. Their concerns and our responses are summarised as follows -

- (a) Choice of AEOI partners.** Stakeholders are concerned about our priority and criteria in selecting AEOI partners for Hong Kong. Our priority now is to formulate the legislative proposals and put in place the framework for timely implementation of AEOI. In identifying potential candidates from our existing or future CDTA / TIEA partners, our **guiding principles** are that they should have the capability in meeting the OECD standard and relevant safeguards in their domestic law for protecting data privacy and confidentiality of the information exchanged. We will, as in the past, solicit views from stakeholders on the priorities for AEOI negotiations on a regular basis.
- (b) Scope of exemptions for certain FIs and financial accounts.** While recognizing that OECD has stipulated a unified and common scope of coverage for FIs and reportable accounts, some FIs have flagged up examples of financial entities or accounts which may bear similar characteristics as those of the non-reportable FIs or excluded accounts under the OECD standard but which could be caught by the definitions therein. We have explained that in considering any possible exemptions for FIs or financial accounts, we need to ensure that the exemptions would **not** frustrate the objective of ensuring our compliance with the OECD standard nor upset the level-playing field of the financial services sector. We would apply the overriding criteria as set out under CRS that any FIs which are exempted from reporting should be those which bear low risks of being used for tax evasion, subject to regulation

and information reporting to the tax authorities, and that the exemption would not otherwise frustrate the objective of CRS. We would study FIs' requests on each own merits, taking into account the above considerations, and provide for necessary exemptions clearly in the law.

(c) Possibility of leveraging on existing due diligence requirements to minimize cost and burden of compliance. FIs are now required under the law to carry out specific due diligence requirements for Anti-Money Laundering and Counter Terrorist Financing (“AML”) purposes to collect personal data information on account holders, and to ascertain the identity of customers and beneficiaries of financial accounts. FIs have voiced concerns on the additional due diligence requirements under AEOI and asked that any gaps between the two set of requirements (such as the detailed procedures in relation to permanent residence test, the threshold for determining beneficiaries of accounts, etc.) be clarified or minimized such that they could build on their existing AML or “know-your-customer (KYC)” mechanism and perform due diligence for AEOI. We reckon FIs' concerns. In fact, CRS sets out that FIs are expected to ride on the existing AML or KYC procedures to identify the personal data required from account holders for AEOI purpose where appropriate and necessary. We will work with FIs and regulatory bodies with a view to **minimizing gaps and clarifying inconsistencies** as far as possible, where bearing in mind the different distinct purposes of the two set of due diligence requirements.

(d) Approach for identifying and collecting information from reportable accounts. One of the issues flagged up in our consultation is whether FIs should be mandated to identify and keep information of accounts corresponding to the **reportable jurisdictions only** (i.e. those jurisdictions with Hong Kong has entered into a CAA for AEOI purpose) or non-Hong Kong tax resident accounts of **all jurisdictions**. Views are divided. Some prefer the “wider approach” so that they can complete due diligence requirements in a timely and efficient manner, by seeking information of all non-Hong Kong tax resident-account holders in one go. However, some other FIs are concerned that a “wider approach” would add to compliance costs. We have explained that Government would need to ensure that our legislative approach would not be called into question on proportionality ground as Hong Kong has

no plans to enter into a multilateral agreement on AEOI (though Hong Kong is expected to enter into bilateral CAAs from among our existing CDTA /TIEA partners and perhaps a few new ones in the coming years). In the circumstances, we intend to only prescribe, in the proposed legislation, the procedures for FIs to identify reportable accounts with residence corresponding to the specific reportable jurisdictions (rather than all jurisdictions outside Hong Kong). FIs would then be required to identify, furnish and report to IRD the information of those account holders who are tax residents of a certain jurisdiction as and when IRD enters into a CAA with the competent authority of that jurisdiction. In case FIs opt to identify and keep information of all non-Hong Kong tax resident-account holders, over and above the proposed legal requirements for specific reportable jurisdictions, Government would have an open mind subject to FIs being able to comply with the data privacy regime in Hong Kong, such as demonstrating that their manner of collection is necessary to achieve the legal purpose of data collection of data and informing data holders of the purpose of collection, etc.. In the light of all feedback received from FIs, we would give further thoughts to the preferred approach in drafting the legislative proposals.

(e) Confidentiality safeguards and monitoring of AEOI partners' compliance. Stakeholders have raised concerns on the confidentiality of information exchanged under AEOI and how Hong Kong can monitor compliance by AEOI partners. We attach **great importance** to protecting the privacy of taxpayers and confidentiality of information, and ensuring the proper use of information exchanged. By riding on the CDTAs and TIEAs that we have signed, we would rely on the relevant safeguards thereunder to protect data privacy and confidentiality of information. Further, as provided for under CAA, should there be any non-compliance by AEOI partners, IRD may terminate the CAA by giving notice to the other competent authority and the termination may take immediate effect pending completion of negative vetting process.

(f) Ascertaining tax residence of account holders. Some FIs have sought clarification of their responsibility in determining tax residence of account holders. We have stressed that following the spirit of CRS, **account holders are responsible for identifying their own tax residence.** If account holders are in doubt, they should seek advice

from their own lawyers or tax advisors. As far as we understand, OECD will establish a portal to help disseminate information regarding different tax laws in defining tax residence. On the part of FIs, they are not expected to carry out any independent legal analysis of relevant tax laws to determine the residence of an account holder. Their role is limited to the performance of a reasonableness test of the self-certification by an account holder.

(g) Proposed penalties. A few stakeholders consider that the proposed penalties may be too heavy for FIs and that there should be no criminal sanctions. We would like to emphasize that **it is essential to put in place appropriate penalty provisions** to provide for sufficient deterrent effect to ensure effective implementation of the AEOI regime in Hong Kong. The penalties (i.e. level 3) currently proposed are much lower than those under AMLO (i.e. level 5) and compliance with due diligence can be a ground of defense for incomplete or inaccurate reporting to IRD. We will, however, consider the views received and review the proposed penalties.

(h) How to file AEOI returns by FIs. FIs have to make early preparations for putting in place the information technology (IT) systems and due diligence process. In this regard, IRD is developing a secure platform, an **AEOI Portal**, for FIs to submit notifications and file AEOI Returns electronically. FIs would be required to use digital certificates for authentication and open online accounts for transacting with IRD on matters relating to AEOI. The established IT safeguards and requirements will apply strictly.

Progress Report to Global Forum

14. Hong Kong and the other 90 jurisdictions committing to AEOI are required to report progress and submit initial implementation plans before the Global Forum Plenary Meeting in October 2015. Progress reports are then required on an annual basis. The Global Forum will conduct a peer review on members regarding AEOI implementation from 2017 onwards. Committed jurisdictions are expected to go through peer review on the effectiveness of the legal framework and the actual implementation of AEOI. It is crucial for Hong

Kong to pass the peer review so as not to be labelled as a “non-compliant” or “non-cooperative” tax jurisdiction, otherwise our position as an international financial centre will be seriously undermined.

Legislative and Implementation Timetable

15. Our current target is to introduce an amendment bill into LegCo in early 2016. Subject to enactment of the legislation before end 2016, FIs will need to start conducting due diligence procedures in respect of their financial accounts in 2017. We have committed to commence the first automatic information exchanges by the end of 2018 the latest. We are working under a very tight timetable. We will consult stakeholders and Members of LegCo on the draft Bill when it is ready in late 2015.

Financial Services and the Treasury Bureau June 2015

Key requirements of CAA and CRS

We propose to include in IRO definitions of FIs as follows –

- (a) **“Custodial institution”** - a trust company registered under the Trustee Ordinance (Cap. 29); or any other person that holds, as a substantial portion of his business, financial assets for the account of others;
- (b) **“Depository institution”** - an authorized institution licensed or registered under the Banking Ordinance (Cap. 155); or a credit union registered under the Credit Unions Ordinance (Cap. 119)*;
- (c) **“Specified insurance company”** – (i) an insurer authorized under the Insurance Companies Ordinance (Cap. 41); (ii) an entity the gross income of which arising from insurance, reinsurance, and annuity contracts for the immediately preceding calendar year exceeds 50% of total gross income for such year; or (iii) an entity the aggregate value of the assets of which associated with insurance, reinsurances, and annuity contracts at any time during the immediately preceding calendar year exceeds 50% of total assets at any time during such year; that issues, or is obligated to make payments with respect to, a Cash Value Insurance Contract or an Annuity Contract; and
- (d) **“Investment entity”** —
 - (i) a corporation licensed under the Securities and Futures Ordinance (Cap. 571) to carry out one or more of the following regulated activities -
 - dealing in securities;
 - trading in futures contracts;
 - leveraged foreign exchange trading;
 - asset management;

* We have received and will study a submission from the Hong Kong League of Credit Unions asking defining credit unions as non-reporting FIs.

- (ii) a registered institution under the Securities and Futures Ordinance (Cap. 571) to carry out one or more of the following regulated activities -
 - dealing in securities;
 - trading in futures contracts;
 - asset management;
- (iii) a trust company registered under the Trustee Ordinance (Cap. 29);
- (iv) a collective investment scheme or a structured product authorised under the Securities and Futures Ordinance (Cap. 571);
- (v) any entity that primarily conducts as a business one or more of the following activities or operations for or on behalf of a customer –
 - trading in money market instruments, foreign exchange, exchange, interest rate and index instruments, transferrable securities, or commodity futures trading;
 - individual and collective portfolio management; or
 - otherwise investing, administering, or managing financial assets or money on behalf of other persons; or
- (vi) the gross income of which is primarily attributable to investing, reinvesting, or trading in financial assets, if the entity is managed by another entity that is a depository institution, a custodian institution, a specified insurance company, or an investment entity described in subparagraph (v) above.

2. As for **reportable accounts**, we propose to prescribe them as accounts held by persons who are tax residents of the reportable jurisdictions. Reportable accounts also include accounts held by a Passive Non-Financial Institution Entity (“NFE”) with Controlling Persons who are tax residents of the reportable jurisdictions.

3. For **non-reporting FIs**, we intend to include –

- (a) government entities (including statutory body and entities which are wholly owned by the Government), international organisations, Hong

Kong Monetary Authority;

- (b) pension fund of a government entity, international organisation or the Hong Kong Monetary Authority;
- (c) Grant Schools Provident Fund and Subsidized Schools Provident Fund; and
- (d) any FIs meeting the requirements defined as Broad Participation Retirement Fund, Narrow Participation Retirement Fund, qualified credit card issuer, exempt collective investment vehicle or trustee documented trust under CRS.

4. We also intend to exempt the Mandatory Provident Fund Schemes under the Mandatory Provident Fund Scheme Ordinance (Cap. 485) and Occupational Retirement Schemes under the Occupational Retirement Schemes Ordinance (Cap. 426) registered with the Mandatory Provident Fund Schemes Authority, provided that they can demonstrate that they present a low risk of being used to evade tax and are subject to regulation and reporting to IRD.

5. As for **excluded accounts**, we intend to include the following –

- (a) retirement or pension account satisfying certain requirements;
- (b) non-retirement tax-favoured accounts;
- (c) term life insurance contracts;
- (d) estate accounts;
- (e) escrow accounts; and
- (f) depository accounts due to non-returned overpayments as defined under CRS.

6. As for **reportable information**, FIs will be required to report to IRD -

- (a) the **name, address, jurisdiction(s) of residence, TIN(s) and date and place of birth of each reportable person** whether the account holder is an individual or an entity with one or more controlling persons that is a reportable person;

- (b) the **account number** (or functional equivalent in the absence of an account number);
- (c) the **name and identifying number** (if any) of FI;
- (d) the **account balance or value** (including, in the case of a cash value insurance contract or annuity contract, the cash value or surrender value) as of the end of the relevant calendar year or other appropriate reporting period or, if the account was closed during such year or period, the closure of the account;
- (e) in the case of any custodial account -
 - (i) the **total gross amount of interest, the total gross amount of dividends**, and the **total gross amount** of other income generated with respect to the assets held in the account, in each case paid or credited to the account (or with respect to the account) during the calendar year or other appropriate reporting period; and
 - (ii) the **total gross proceeds** from the sale or redemption of financial assets paid or credited to the account during the calendar year or other appropriate reporting period with respect to which the reporting FI acted as a custodian, broker, nominee, or otherwise as an agent for the account holder;
- (f) in the case of any depository account, the **total gross amount of interest** paid or credited to the account during the calendar year or other appropriate reporting period; and
- (g) in the case of any account not described in subparagraph (e) or (f), the **total gross amount** paid or credited to the account holder with respect to the account during the calendar year or other appropriate reporting period with respect to which the reporting FI is the obligor or debtor, including the aggregate amount of any redemption payments made to the account holder during the calendar year or other appropriate reporting period.

Preliminary proposals on penalties⁵

7. To achieve deterrent effect, we propose to sanction **FIs** for –
- (a) **failure to comply with the requirements for carrying out due diligence procedures, furnishing returns to IRD, or any other obligations which facilitate effective implementation of AEOI without reasonable excuse.** This will be an offence and is liable on conviction to a fine at level 3. In the case of a continuing offence after conviction for failure to comply, the FI concerned is liable to a further fine not exceeding \$500 for every day or part thereof during which the offence continues after conviction;
 - (b) **furnishing incorrect returns due to failure to observe in full the due diligence requirements.** Making inaccurate returns is not an automatic trigger for the offence. Under our light-handed legislative approach, compliance with the due diligence procedures and the absence of knowledge about the inaccuracy may be a defence for FIs. The offence is liable on conviction to a fine at level 3. In the case of a continuing offence after conviction for failure to comply, the FI concerned is liable to a further fine not exceeding \$500 for every day or part thereof during which the offence continues after conviction;
 - (c) **wilfully making a return to mislead or deceive.** This relates to the use of fraudulent acts to evade the due diligence requirements or to defraud IRD. This will be an offence and –
 - (i) on summary conviction liable to a fine at level 3 and imprisonment for six months; or
 - (ii) on indictment liable to a fine at level 5 and imprisonment for three years.
8. Further, modelled on the AMLO, we propose to impose penalties on a person who is the **employee** of an FI, employed to **work for** an FI or concerned in the **management** of an FI, for –

⁵ These are subject to further refinement having regard to the views collected during the consultation period.

- (a) **without reasonable excuse**, causing or permitting the FI to fail to comply with the requirements imposed on FIs or to cause/permit the FIs to furnish incorrect returns. Such an offence will be liable to a fine at level 3. In the case of a continuing offence after conviction for failure to comply, the employee concerned is liable to a further fine not exceeding \$500 for every day or part thereof during which the offence continues after conviction; and
- (b) **wilfully to defraud**, causing or permitting the FIs to fail to comply with the requirements imposed on the FIs or to make incorrect return. Such an offence will be liable on summary conviction to a fine at level 3 and imprisonment for six months; or on indictment to a fine at level 5 and imprisonment for three years.

9. We do not intend to impose a host of new sanctions on **non-Hong Kong tax resident account holders** specifically for the purpose of AEOI. Under IRO, any person who without reasonable excuse gives any incorrect information to IRD for the purpose of exchange of tax information in relation to any matter affecting the person's own liability to any tax of a territory outside Hong Kong (i.e. Hong Kong's CDTA/TIEA partners) already commits an offence. In this regard, we may consider expanding the existing sanction or imposing a new specific sanction to cover false self-certification from individual account holders, with a view to enhancing the reliability of the self-certification process.

List of Bodies and Associations briefed in the Consultation Period

1. Joint Liaison Committee for Taxation
2. Hong Kong Association of Banks
3. Hong Kong Trustees' Association
4. Hong Kong Investment Funds Association
5. Hong Kong Federation of Insurers
6. Hong Kong League of Credit Unions
7. Hong Kong Federation of Share Registrars
8. Private Wealth Management Association
9. Asia Securities Industries and Financial Markets Association
10. Alternative Investment Management Association – Hong Kong Branch
11. Society of Trust and Estate Practitioners Hong Kong Branch
12. Hong Kong Securities Association
13. Hong Kong Securities Professionals Association
14. Hong Kong Securities and Futures Professionals Association
15. Hong Kong Institute of Financial Analysts and Professional Commentators Ltd
16. Hong Kong Association of Online Brokers Limited
17. Hong Kong Securities and Futures Employees Union
18. Hong Kong Precious Metals Traders Association Ltd
19. Institute of Securities Dealers
20. Chinese Financial Association of Hong Kong
21. Chinese Securities Association of Hong Kong
22. CSOP Asset Management Ltd
23. Computershare Hong Kong Investor Services Ltd
24. Hong Kong Exchanges and Clearing Ltd
25. Hong Kong Monetary Authority
26. Securities and Futures Commission
27. Mandatory Provident Fund Schemes Authority
28. Office of the Commissioner of Insurance
29. Association of Chartered Certified Accountants Hong Kong
30. Hong Kong Institute of Certified Public Accountants
31. The Taxation Institute of Hong Kong
32. Law Society of Hong Kong
33. Hong Kong Bar Association

34. Capital Market Tax Committee of Asia
35. Society of Chinese Accountants and Auditors
36. The Association of Hong Kong Accountants
37. Hong Kong General Chamber of Commerce
38. Chinese General Chamber of Commerce
39. Federation of Hong Kong Industries
40. Belgium-Luxembourg Chamber of Commerce in Hong Kong
41. British Chamber of Commerce in Hong Kong
42. Finnish Chamber of Commerce in Hong Kong
43. French Chamber of Commerce and Industry
44. German Chamber of Commerce in Hong Kong
45. Indian Chamber of Commerce in Hong Kong
46. Mexican Chamber of Commerce in Hong Kong
47. New Zealand Chamber of Commerce in Hong Kong
48. San Marino Chamber of Commerce in Hong Kong
49. The Hong Kong Japanese Chamber of Commerce and Industry