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**Panel on Financial Affairs**

**Meeting on 6 July 2015**

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

**Purpose**

This paper provides background information on automatic exchange of financial account information ("AEOI"). It also summarizes the views and concerns expressed by Members when the matter and 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") from 2009 to 2015.

**Existing policy on EoI arrangements**

2. At present, Hong Kong is only able to exchange tax information upon request with its treaty partners under either CDTAs<sup>1</sup> or TIEAs<sup>2</sup>. The EoI regime and related safeguards in Hong Kong are provided in the Inland Revenue Ordinance (Cap. 112)("IRO"), the Inland Revenue (Disclosure of Information) Rules (Cap. 112 sub leg BI) ("the Disclosure Rules")<sup>3</sup> and the relevant Orders implementing individual CDTAs/TIEAs. These safeguards are

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<sup>1</sup> 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 taxation. 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. All CDTAs signed embody a mechanism for EoI up to the international standard as far as practicable.

<sup>2</sup> A TIEA is a form of agreement for EoI which carries no double taxation relief. The Inland Revenue (Amendment) (No. 2) Ordinance 2013 enacted by LegCo at the meeting of 10 July 2013 has put in place a legal framework for Hong Kong to enter into standalone TIEAs with other jurisdictions. Hong Kong concluded its first TIEA with the United States on 25 March 2014.

<sup>3</sup> 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.

generally based on the 2004 version of the EoI Article in the Organization for Economic Cooperation and Development ("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. The current EoI under CDTAs/TIEAs is operated on a request basis.

### **The Administration's initiative to pursue automatic exchange of information in tax matters in Hong Kong**

3. For the purpose of enhancing tax transparency and combating cross-border tax evasion, OECD released the Standard for Automatic Exchange of Financial Account Information in Tax Matters ("the AEOI Standard") 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 on Transparency and Exchange of Information for Tax Purposes ("Global Forum")<sup>4</sup> of OECD has invited all its members including Hong Kong to commit to implementing the new global AEOI standard. On 15 September 2014, the Government indicated to the Global Forum Hong Kong's support for implementing the new standard on AEOI, with a view to commencing the first information exchange by the end of 2018<sup>5</sup>. The commitment is premised on the condition that Hong Kong could put in place the necessary domestic legislation by 2017. The Government's plan is to introduce the relevant legislative proposals into LegCo in early 2016 to implement the AEOI Standard in Hong Kong.

#### *Main features of AEOI*

4. AEOI involves systematic and periodic transmission of financial account information by the source jurisdiction to the jurisdiction of residence of the account holders concerning all types of investment income, account balances or values, and sales proceeds from financial assets on an annual basis. The scope of financial account information to be exchanged is prescribed and unified in accordance with the international standard. "Automatic exchange" does not mean that there will be free flow of information to all other jurisdictions. Rather, the exchange is conducted on an annual basis within the confines of an EoI agreement signed between the tax authorities of two or more jurisdictions. Moreover, the AEOI Standard itself consists of a fully reciprocal system, and the terms, concepts and approaches have been standardized

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<sup>4</sup> The Global Forum consists of some 120 member jurisdictions including Hong Kong.

<sup>5</sup> According to the Government, end of 2018 is the latest timeline for implementing AEOI as promulgated by the Global Forum.

allowing jurisdictions to use the system without having to negotiate individual terms, so that the standard is universal and can be applicable to all jurisdictions. A summary of the key components of the AEOI Standard is in **Appendix I**. A diagram illustrating the differences between how EoI on request and AEOI work is in **Appendix II**.

*The Administration's proposed legal framework to implement AEOI*

5. As advised by the Administration during the briefing on the new AEOI regime at the meeting of the Panel of Financial Affairs ("FA Panel") held on 3 November 2014, the Government's initial thinking is to amend IRO to put in place the necessary enabling provisions for AEOI, and to make use of the bilateral EoI instruments (i.e. CDTA or TIEA) as the legal basis for implementing AEOI. This means that Hong Kong's future AEOI partner must either be its CDTA or TIEA partner. The proposed legal framework will include the following key components:

- (a) obligations on financial institutions to undertake due diligence procedures to identify reportable accounts and to furnish annual returns to the Inland Revenue Department ("IRD") on the financial information in respect of the accounts in the format as prescribed by the Commissioner of Inland Revenue ("CIR");
- (b) record-keeping and return requirements to enable financial institutions to collect, keep and report required information to CIR and to enable CIR to verify their compliance;
- (c) powers for IRD to gather information on reportable accounts from financial institutions in prescribed format for the purpose of AEOI;
- (d) safeguards to protect data privacy and confidentiality following international standards; and
- (e) sanctions to ensure compliance.

The Government launched a consultation exercise on the proposed AEOI regime in Hong Kong from 24 April 2015 to 30 June 2015.

**Concerns and views expressed by Members**

6. The Administration briefed FA Panel on the latest international development in enhancing tax transparency and its initiative to pursue the AEOI regime in Hong Kong at the meeting on 3 November 2014. Issues related to the AEOI regime were discussed during the session on public finance of the

special meetings of the Finance Committee to examine the Estimates of Expenditure 2015-2016. Moreover, issues relating to the operation of the existing EoI mechanism were discussed at meetings of FA Panel 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, the two Orders made under sections 49 and 49(1A) of IRO and gazetted on 17 October 2014 to implement the CDTAs entered between Hong Kong and Korea and Vietnam 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 implementing AEOI for Hong Kong

7. While some Members considered that Hong Kong should uphold its responsibility in international tax cooperation to implement AEOI and expressed concern about Hong Kong losing its competitiveness vis-à-vis other jurisdictions as an international financial centres if it failed to do so, some other Members had reservation about the benefits on Hong Kong in pursuing AEOI and concern that implementing AEOI might undermine Hong Kong's simple taxation system in attracting businesses and talents. These Members enquired about the possible consequences if Hong Kong did not implement AEOI.

8. The Administration advised that over 90 jurisdictions had already publicly committed to the implementation of AEOI in 2017 or 2018. In view of the increasing aspirations of the international community for AEOI as a more efficient mode of international tax cooperation and a new global standard, it was necessary for Hong Kong to put in place the required legal framework for effecting AEOI. Otherwise, there might be risks for Hong Kong being labeled as an uncooperative jurisdiction or a "tax haven", which in turn would adversely affect its position and competitiveness as an international business and financial centre. On the benefits of AEOI, the Administration pointed out that there were previous cases in which information exchanged with other jurisdictions had enabled IRD to detect unreported taxable income of Hong Kong taxpayers sourced from Hong Kong and held in overseas financial accounts.

### Implementation of AEOI

9. Some Members envisaged that there might be strong opposition from the business sector and financial institutions to the implementation of AEOI and enquired how the Administration would solicit support from these parties. Members also stressed the need for the Administration to minimize the

compliance costs on financial institutions in respect of retaining and reporting tax information under AEOI.

10. The Administration advised that in putting forward the legislative proposals on AEOI, it was mindful of the need to address concerns of the business sector and the public about protection of privacy and confidentiality of the information exchanged. The Administration would continue to explain the details and seek the views of various stakeholders on the legislative proposals, as well as include appropriate safeguard measures as necessary. The Administration would also consider the implications arising from AEOI on the compliance costs of financial institutions and the manpower resources of IRD.

11. Members were concerned about the potential financial loss caused to financial account holders and adverse impact on the business of financial institutions arising from reporting of financial account information and tax enforcement, and whether the financial institutions concerned would be held liable if the relevant account holders had provided false information on their tax residence.

12. The Administration advised that reportable persons under AEOI standard were defined with reference to tax residence (rather than citizenship or nationality). The Common Reporting Standard included due diligence procedures to be performed by financial institutions for identification of reportable accounts. As long as the financial institutions had followed the relevant due diligence requirements, they would be treated as complying with the requirements. The Administration would keep close liaison with the relevant stakeholders on AEOI matter to address their concerns and seek clarification from the Global Forum where necessary and appropriate.

13. On the scope of financial institutions to which Hong Kong's AEOI regime would apply, the Administration advised that only financial institutions incorporated or had permanent establishment in Hong Kong would be required to report financial account information of the overseas tax residents to IRD.

#### Protection of privacy and confidentiality of information exchanged

14. Members stressed the importance to strike a proper balance between tax transparency and protection of data privacy in the exchange of financial account information in implementing the proposed AEOI regime, and highlighted the needs for IRD to identify AEOI partner carefully and prevent fishing expedition by partners in tax information exchange. They further raised concern about the potential difficulties for and resource implications on IRD in ascertaining the nature and source of reportable income and genuine recipient/beneficiary of the income.

15. The Administration pointed out that the exchange of information under AEOI would be conducted on an annual basis within the confines of an EoI agreement signed between the tax authorities of two or more jurisdictions instead of a free flow of information among jurisdictions. The Administration would identify appropriate AEOI partners which could meet relevant requirements on protection of privacy and confidentiality of information exchanged and ensuring proper use of data. Similar to the safeguards available in the existing EoI mechanism for CDTAs or TIEAs, the AEOI standard would contain specific rules on the confidentiality of the information exchanged, including ensuring that the information exchanged should be foreseeably relevant, i.e. no fishing expeditions.

16. On the question of whether commercial information exchanged under AEOI could be disclosed/referred to an enforcement authority, the Administration advised that the information (including commercial information) would only be disclosed to tax authorities concerned with assessment or collection of, and enforcement or prosecution in respect of and the determination of appeals in relation to taxes falling within the scope of AEOI, but not for release to their oversight bodies or enforcement authorities for non-tax purposes (e.g. enforcement against money laundering or other serious crimes), unless otherwise agreed between the contracting parties.

17. Regarding Members' concern about the scope of information disclosure under the existing 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.

18. As regards protection of the confidentiality of the tax information exchanged with another jurisdiction under the existing EoI mechanism, 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.

### Review of CDTAs and TIEAs

19. Members had requested the Administration to conduct regular reviews of the CDTAs/TIEAs that Hong Kong had entered/would enter into so as to ensure that the interests of Hong Kong taxpayers would not be 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**

20. At the meeting of FA Panel on 6 July 2015, the Administration will brief members on the preliminary outcome of the consultation exercise and the proposed model for AEOI in Hong Kong.

### **Relevant papers**

21. A list of relevant papers is in the **Appendix III**.

### **Key Components of the Standard on Automatic Exchange of Financial Account Information in Tax Matters ("Standard on AEOI") published by the Organisation for Economic Cooperation and Development in July 2014**

The Standard on AEOI comprises the following –

- (a) **Model Competent Authority Agreement (“Model CAA”):**  
This forms the legal basis for the exchange of information, allowing the financial account information to be exchanged. It provides for the modalities of the exchange to ensure the appropriate flow of information. It also contains provisions on confidentiality and safeguards for an effective exchange of information.
  
- (b) **Common Reporting Standard (“CRS”):**  
This defines the reporting and due diligence rules for financial institutions for identification of reportable accounts, which has to be translated into domestic law by participating jurisdictions. Specifically, it covers the following key aspects –
  - (i) The financial institutions covered include banks, custodians, insurance companies, brokers and investment entities (such as certain collective investment vehicles), unless they present a low risk of being used for evading tax and are excluded from reporting (such as prescribed retirement schemes).
  
  - (ii) The scope of information to be reported covers financial accountholders’ personal data (i.e. name, address, tax residence and taxpayer identification number of the account holder) and financial data (i.e. interest, dividends, account balance or value, income from certain insurance products, sales proceeds from financial assets and other income generated with respect to assets held in the account or payment made with respect to the account).
  
  - (iii) Reportable accounts include accounts held by individuals and entities (which include foundations and trusts), and the standard includes a requirement to look through passive entities to report on the relevant controlling persons (i.e. the beneficial owners).
  
  - (iv) The due diligence procedures to be performed by financial institutions distinguish between individual and entity accounts, and they also make a difference between pre-existing and new accounts



(c) Commentaries on the Model CAA and the CRS:

In order to ensure consistent application and operation of the AEOI standard, there is a detailed Commentary for each section of the Model CAA and the CRS. For certain limited situations, alternatives are also provided in the Commentaries. In particular, it provides that both bilateral treaties (such as the exchange of information article under the comprehensive agreements for avoidance of double taxation and the tax information exchange agreements) and the Multilateral Convention on Mutual Administrative Assistance in Tax Matters are legal instruments readily available for effecting AEOI. In other words, a jurisdiction should first sign a bilateral treaty or the Multilateral Convention and then sign the Model CAA before proceeding to actual AEOI.

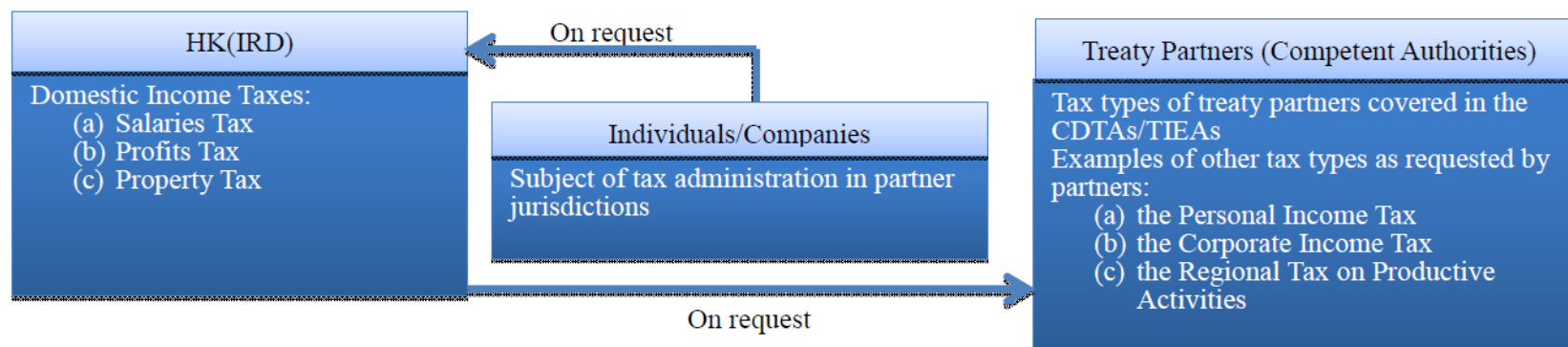
(d) Guidance on Technical Solutions:

This includes a schema to be used for exchanging the information and provides a standard in relation to the information technology aspects of data safeguards and confidentiality, and transmission and encryption for the secure transmission of information under the CRS.

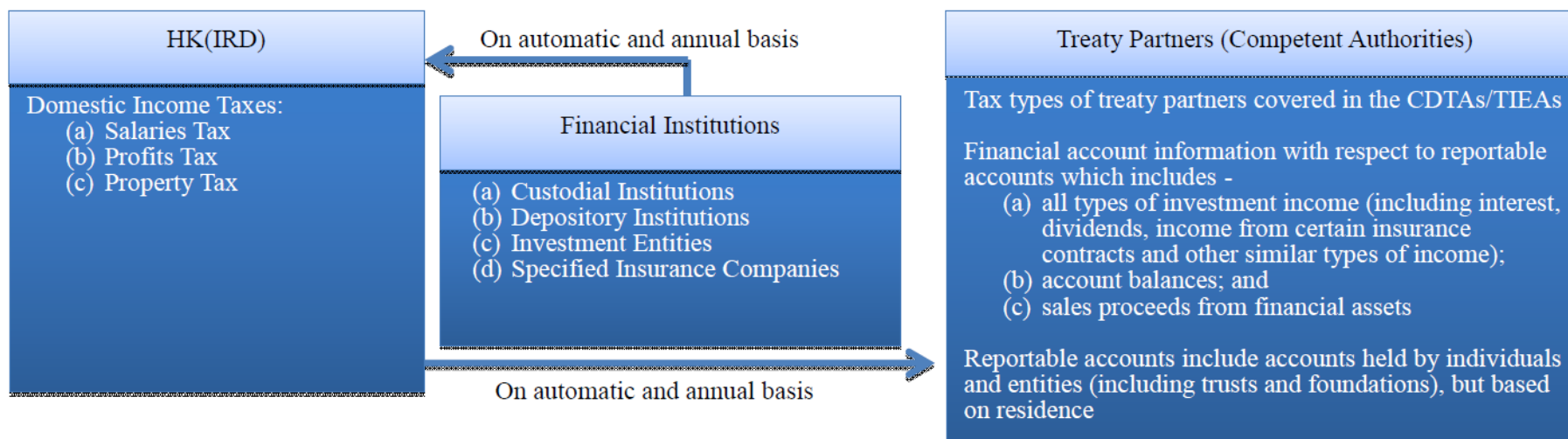
[*Source:* Extract from the paper provided by the Administration for the meeting of the Panel on Financial Affairs on 3 November 2015 (LC Paper No. CB(1)122/14-15(03)).]

**Differences between the Operation of EoI on Request and AEOI**

**(a) Exchange of Information (EOI) on Request**



**(b) Automatic Exchange of Financial Account Information (AEOI)**



[Source: Annex to the paper provided by the Administration for the meeting of the Panel on Financial Affairs on 3 November 2015 (LC Paper No. CB(1)122/14-15(03)).]

**List of relevant papers**

<b>Date</b>	<b>Event</b>	<b>Papers/Minutes of meeting</b>
4 May 2009	The Panel on Financial Affairs ("FA Panel") discussed the extension of the network of agreements for avoidance of double taxation	<a href="#">Discussion paper</a> (LC Paper No. CB(1)1408/08-09(03))  <a href="#">Minutes</a> (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	<a href="#">Administration's paper</a> (LC Paper No. CB(1)91/12-13(04))  <a href="#">Minutes</a> (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	<a href="#">Administration's paper</a> (LC Paper No. CB(1)484/12-13(05))  <a href="#">Minutes</a> (LC Paper No. CB(1)930/12-13)
10 July 2013	The Legislative Council passed the Inland Revenue (Amendment) Bill 2013	<a href="#">Hansard</a>  <a href="#">Report of the Bills Committee</a> (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	<a href="#">Report of the subcommittee</a> (LC Paper No. CB(1)350/13-14)

<b>Date</b>	<b>Event</b>	<b>Papers/Minutes of meeting</b>
May 2014	The relevant subcommittee studied the Inland Revenue (Exchange of Information relating to Taxes) (United States of America) Order	<a href="#">Background brief</a> (LC Paper No. CB(1)1397/13-14(01))  <a href="#">Report of the subcommittee</a> (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	<a href="#">Press release issued by the Financial Services and the Treasury Bureau</a>
3 November 2014	FA Panel was briefed by the Administration on the latest development on tax transparency and the Administration's preliminary thinking on how to pursue automatic exchange of financial account information ("AEOI") in tax matters in Hong Kong	<a href="#">Administration's paper</a> (LC Paper No. CB(1)122/14-15(03))  <a href="#">Minutes</a> (LC Paper No. CB(1)379/14-15)
November 2014	The relevant subcommittee studied the two Orders made under sections 49 and 49(1A) of the Inland Revenue Ordinance and gazetted on 17 October 2014 for implementing the comprehensive agreements for avoidance of double taxation entered between Hong Kong and Korea and Vietnam	<a href="#">Report of the subcommittee</a> (LC Paper No. CB(1) 290/14-15)

<b>Date</b>	<b>Event</b>	<b>Papers/Minutes of meeting</b>
30 March 2015	Special meetings of the Finance Committee to examine the Estimates of Expenditure 2014-15 (session on public finance)	<u>Speaking note of the Secretary for Financial Services and the Treasury</u> <u>Administration's replies to Members initial written questions</u>
24 April 2015 to 30 June 2015	The Administration launched a consultation exercise on AEOI in tax matters in Hong Kong	<u>Press release</u> <u>Consultation document</u>