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**Subcommittee on Inland Revenue Ordinance  
(Amendment of Schedule 17E) Notice 2016**

**Background brief**

**Purpose**

This paper provides background information on the Inland Revenue Ordinance (Amendment of Schedule 17E) Notice 2016 ("the Amendment Notice"). It also summarizes the views and concerns expressed by Members when issues relating to the implementation of automatic exchange of financial account information in tax matters ("AEOI") in Hong Kong were discussed by relevant committees of the Legislative Council ("LegCo") in the 2014-2015 and 2015-2016 legislative sessions.

**Background**

Hong Kong's policy approach for automatic exchange of financial account information in tax matters

2. For the purpose of enhancing tax transparency and combating cross-border tax evasion, the Organisation for Economic Co-operation and Development ("OECD") released in July 2014 the "Standard for Automatic Exchange of Financial Account Information in Tax Matters" ("AEOI Standard").<sup>1</sup> In brief terms, the AEOI Standard requires a financial institution ("FI") to conduct due diligence procedures to identify reportable accounts held by tax residents of reportable jurisdictions (i.e. tax residents who are liable to

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<sup>1</sup> 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.

tax by reason of residence in the AEOI partner jurisdictions),<sup>2</sup> and collect the required information in respect of these reportable accounts. FIs are also required to report such information to the tax authority in a specified format. Upon receipt of the information from FIs, the tax authority will exchange the relevant information with their counterparts in the reportable jurisdictions concerned on an annual basis.

3. In order to catch up with the latest international standard on AEOI, Hong Kong indicated to the Global Forum on Transparency and Exchange of Information for Tax Purposes ("Global Forum") of OECD in September 2014 its support for implementing AEOI on a reciprocal basis with appropriate partners, with a view to commencing the first information exchange by end of 2018 (i.e. the latest timeline permissible by the Global Forum).<sup>3</sup>

4. In this regard, the Administration intends to conduct AEOI only with partners with which Hong Kong has signed comprehensive avoidance of double taxation agreements ("CDTAs") or tax information exchange agreements ("TIEAs") on a bilateral basis under the exchange of information ("EOI") mechanism.<sup>4</sup> Under this approach, Hong Kong will make use of the bilateral CDTAs or TIEAs signed as the legal basis for implementing AEOI. To enable AEOI, the Inland Revenue Department ("IRD") will have to sign a new Competent Authority Agreement ("CAA"), which sets out the modalities of transfer of information collected pursuant to the AEOI Standard, with the tax authority of the CDTA/TIEA partner concerned.

#### Inland Revenue (Amendment) (No. 3) Ordinance 2016

5. Against the above background, the Administration enacted the Inland Revenue (Amendment) (No. 3) Ordinance 2016 ("the Amendment Ordinance"), which came into effect on 30 June 2016, to provide for the legal framework for

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<sup>2</sup> Under section 50A of the Inland Revenue Ordinance (Cap. 112), "financial institution" means (a) a custodial institution; (b) a depository institution; (c) an investment entity; or (d) a specified insurance company. For the purpose of implementing AEOI in Hong Kong, only FIs which are resident in Hong Kong will be subject to the reporting requirements.

<sup>3</sup> The Global Forum consists of some 120 member jurisdictions including Hong Kong.

<sup>4</sup> CDTAs are tax agreements which seek to minimize incidence of double taxation between the contracting parties and provide a mechanism for EOI between tax authorities, whereas TIEAs serve as EOI instruments without offering any taxation relief. As at November 2016, Hong Kong has signed CDTAs with 35 jurisdictions and TIEAs with seven jurisdictions.

implementing AEOI in Hong Kong.<sup>5</sup> The Amendment Ordinance amended the Inland Revenue Ordinance (Cap. 112) ("IRO") to incorporate the essential requirements of the AEOI Standard.

6. The Amendment Ordinance has added a new section 50J to IRO, which empowers the Secretary for Financial Services and the Treasury ("SFST") to amend, among others, Schedule 17E to IRO to provide for a list of reportable jurisdictions and a list of participating jurisdictions.<sup>6</sup>

#### *Reportable jurisdictions*

7. Under Hong Kong's AEOI regime, a reportable jurisdiction refers to a jurisdiction with which Hong Kong has entered into CDTA/TIEA and CAA for the conduct of AEOI (i.e. Hong Kong's AEOI partner jurisdiction). According to the Administration, it will take a progressive approach in identifying Hong Kong's AEOI partners and will start with a few jurisdictions at the outset.

#### *Participating jurisdictions*

8. In the context of Hong Kong, a participating jurisdiction refers to a territory outside of Hong Kong that is committed to adopting AEOI by 2018. In accordance with the AEOI Standard, when performing due diligence procedures, FIs are required to "look through" an account holder which is a professionally-managed investment entity residing in a non-participating jurisdiction, and see if any of the controlling persons of the entity is a tax resident of a reportable jurisdiction. If affirmative, the FI concerned is required to report such information to IRD for exchange with the reportable jurisdictions concerned. This "look through requirement" would not apply if the entity is a resident in a participating jurisdiction. Hence, the extent to which FIs in Hong Kong are required to conduct "look through" checks depends on the list of participating jurisdictions.

### **Inland Revenue Ordinance (Amendment of Schedule 17E) Notice 2016**

9. On 28 October 2016, the Administration published in the Gazette the Amendment Notice which seeks to amend Schedule 17E to IRO, as added by the Amendment Ordinance, by including:

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<sup>5</sup> The Inland Revenue (Amendment) Bill 2016 was introduced into LegCo on 20 January 2016, and passed on 22 June 2016. A Bills Committee was formed to examine the Bill.

<sup>6</sup> SFST may amend Schedule 17E to IRO by notice in the Gazette, which is subject to negative vetting by LegCo.

- (a) in Part 1 of Schedule 17E, Japan and the United Kingdom of Great Britain and Northern Ireland, with which IRD has signed bilateral CAAs so far, as "reportable jurisdictions", with 2018 as the corresponding "reporting year";<sup>7</sup> and
- (b) in Part 2 of Schedule 17E, all jurisdictions which have committed to adopting AEOI by 2018 (i.e. in total 100 such jurisdictions excluding Hong Kong) as "participating jurisdictions".

10. The Amendment Notice was tabled before LegCo at its sitting of 2 November 2016 for negative vetting. It will come into operation on 31 December 2016.

### **Major views and concerns expressed by Members**

11. Matters relating to the implementation of an AEOI regime in Hong Kong were discussed at the meetings of the Panel on Financial Affairs on 3 November 2014 and 6 July 2015, the Bills Committee on Inland Revenue (Amendment) Bill 2016, and the Finance Committee during examination of the Estimates of Expenditure 2015-2016 on 30 March 2015. The major views and concerns expressed by Members during these meetings are summarized in the ensuing paragraphs.

#### Justifications for implementing automatic exchange of financial account information in tax matters

12. While some Members considered that Hong Kong should implement AEOI in order to fulfil its responsibility in international tax cooperation, some other Members queried the benefits of the initiative and were worried that AEOI might undermine the attractiveness of Hong Kong's simple tax regime to businesses and talents.

13. The Administration advised that the vast majority of member jurisdictions of the Global Forum, including a significant number of Hong Kong's major trading partners, had already committed to implementing AEOI. From 2017 onwards, the Global Forum would conduct a peer review on member jurisdictions regarding the effectiveness of their legal frameworks for AEOI, and their progress in implementing AEOI. It would be crucial for Hong Kong to pass the peer review to avoid being labelled as an uncooperative tax jurisdiction and the possibility of having sanctions imposed on Hong Kong

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<sup>7</sup> The reporting year for a reportable jurisdiction is the year beginning from which a notice may be given under section 50C(2) of IRO requiring information on reportable accounts with respect to that jurisdiction.

unilaterally. The Administration added that Hong Kong could benefit from implementing AEOI on a reciprocal basis as it might enable IRD to obtain more comprehensive financial information of Hong Kong taxpayers, which could facilitate its assessment and recovery of tax in default.

#### Criteria for identifying reportable jurisdictions

14. Members enquired about the criteria for identifying potential AEOI candidates (i.e. reportable jurisdictions) from Hong Kong's existing or future CDTA/TIEA partners. The Administration advised that in principle, the potential AEOI candidates should be capable of meeting the AEOI Standard, and have relevant safeguards in their domestic laws for protecting data privacy and confidentiality of the information exchanged. The Administration would also take into account the bilateral trade relationship with the potential AEOI candidates, and the outcome of assessments arising from the review to be conducted by the Global Forum regarding the confidentiality and data safeguards of the jurisdictions committed to implementing AEOI.

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

15. Members stressed the importance to strike a proper balance between tax transparency and protection of personal data privacy in implementing AEOI. They considered it incumbent upon the Administration to identify AEOI partners carefully, and prevent fishing expedition by partners and disclosure of commercial information exchanged under AEOI to enforcement authorities for non-tax purposes.

16. The Administration explained that the EOI article of CDTAs and relevant articles of TIEAs had provided for safeguards to protect taxpayers' privacy and confidentiality of information exchanged, including ensuring that the information exchanged should be foreseeably relevant with a view to avoiding fishing expedition. Given that in Hong Kong, AEOI would be implemented with CDTA and TIEA partners, the safeguards would be equally applicable to information exchanged under the AEOI regime. In addition, the AEOI Standard also provided for similar safeguards. The Model CAA under the AEOI Standard provided that a competent authority might suspend exchange of information or terminate a CAA by giving notice in writing to the other competent authority if there was significant non-compliance by the latter party. In the context of Hong Kong, termination of a CAA might take effect by removal of a reportable jurisdiction from Schedule 17E to IRO through subsidiary legislation.

### Exercising reasonable due diligence by reporting financial institutions

17. Members enquired about how reporting FIs would be taken as having exercised all reasonable due diligence to identify the tax residences of account holders.<sup>8</sup> There was a concern about the difficulty for the reporting FIs to identify reportable accounts, such as where the account holders refused to provide information, or the accounts were pertaining to a trust or estate with a number of beneficiaries and who might be infants or minors. Some members expressed concerns about whether the AEOI-related due diligence requirements would create undue compliance burden on reporting FIs, and considered that the Administration should exercise a flexible and lenient approach in handling non-compliances of reporting FIs at the initial stage of AEOI implementation.

18. The Administration advised that self-certification by account holders would serve an important tool for reporting FIs to fulfil their reporting and due diligence obligations, in particular to determine the tax residences of account holders. In the case of a trust, the trustee had to provide information of the controlling persons (including the beneficiary) in the self-certification to the reporting FIs, which should report discretionary beneficiaries in the year they received distributions from the trust. Prior to the distribution, the reporting FI should have appropriate procedures in place to identify the beneficiaries and determine their jurisdictions of residence. The Administration stressed that reporting FIs were not expected to carry out independent legal analyses of relevant tax laws or carry out investigation to determine the tax residences of the account holders. IRD would promulgate guidelines, which would include a sample self-certification form for reporting FIs' reference and brief them regarding the due diligence and reporting requirements.

19. The Administration further indicated that reporting FIs should start collecting information from account holders who were tax residents of an AEOI partner jurisdiction, in the calendar year following LegCo's approval of the inclusion of the AEOI partner as a reportable jurisdiction. Reporting FIs would then report the information to IRD in the next calendar year. This timeframe should allow ample time for reporting FIs to collect and report the reportable information. As AEOI in Hong Kong would be implemented in a progressive manner (with only a few AEOI partner jurisdictions at the initial stage), it was envisaged that AEOI would not give rise to undue compliance burden on reporting FIs.

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<sup>8</sup> According to the Administration, in general, whether an individual is a tax resident of a jurisdiction would be determined having regard to the person's physical presence or stay in a place (whether over 183 days within a tax year) and not his citizenship, right of abode or nationality. In the case of a company, the test is the place of incorporation or where the central management and control of the entity lie.

20. In response to Members' concerns that the general public might not be familiar with how to ascertain their tax residences in relation to AEOI, the Administration indicated that IRD had uploaded a set of frequently asked questions onto its website to explain the operation and requirements of AEOI, and it would update the relevant information in a timely manner.

Offence relating to the making of self-certification that was misleading, false or incorrect

21. Members were concerned that the imposition of criminal sanction against the offence of providing misleading, false or incorrect information in a self-certification under section 80(2E) of IRO, as added by the Amendment Ordinance, might not be justified. They worried that account holders might be caught by the offence inadvertently as they might not be aware of their legal liabilities when providing information to reporting FIs, or might be unfamiliar with the legal concept of tax residence in jurisdictions outside Hong Kong. Members requested IRD to put in place measures to alert account holders of the need to exercise caution in making self-certification and their legal liabilities. There was also a suggestion that, when there was reasonable doubt, confirmation should be sought by IRD from the account holder concerned on the self-certification made, or the reporting FI should ask the account holder to provide a self-certification again. The Administration was also asked to consider stipulating explicitly in the legislation that the Administration could not rely solely on the self-certification provided by an account holder to establish that the person concerned committed an offence under section 80(2E).

22. The Administration explained that, in essence, (a) IRD could not solely rely on the self-certification to establish that a person had committed an offence, unless the two prescribed conditions under section 80(2E) (namely, the account holder, in making the self-certification, (i) made a statement that was misleading, false or incorrect in a material particular; and (ii) knew, or was reckless as to whether, the statement was misleading, false or incorrect in a material particular) were both met, and (b) the account holder had the opportunity to defend his/her position when making explanation to IRD, and had the right to keep silent as well.<sup>9</sup>

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<sup>9</sup> Hon James TO was not content with the Administration's explanation and moved Committee stage amendments ("CSAs") to the offence provisions relating to the making of a self-certification that was misleading, false or incorrect in the Inland Revenue (Amendment) Bill 2016. The CSAs were negatived.

### **Latest development**

23. At the House Committee meeting on 4 November 2016, Members agreed that a subcommittee should be formed to examine the Amendment Notice.

### **Relevant papers**

24. A list of relevant papers is set out in the **Appendix**.

Council Business Division 1  
Legislative Council Secretariat  
14 November 2016



**Subcommittee on Inland Revenue Ordinance  
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**List of relevant papers**

Date	Event	Paper
3 November 2014	Meeting of the Panel on Financial Affairs	<p>Administration's paper on "Automatic exchange of financial account information in tax matters" (LC Paper No. <a href="#">CB(1)122/14-15(03)</a>)</p> <p>Background brief on "Automatic exchange of financial account information in tax matters" prepared by the Legislative Council Secretariat (LC Paper No. <a href="#">CB(1)122/14-15(04)</a>)</p> <p>Minutes of meeting (LC Paper No. <a href="#">CB(1)379/14-15</a>)</p>
30 March 2015	Special meetings of the Finance Committee to examine the Estimates of Expenditure 2015-16 (session on public finance)	<p><a href="#">Speaking note of the Secretary for Financial Services and the Treasury</a></p> <p><a href="#">Report on the examination of the Estimates of Expenditure 2015-2016</a></p>
6 July 2015	Meeting of the Panel on Financial Affairs	<p>Administration's paper on "Automatic exchange of financial account information in tax matters " (LC Paper No. <a href="#">CB(1)1034/14-15(06)</a>)</p> <p>Updated background brief on "Automatic exchange of financial account information in tax matters" prepared by the Legislative Council Secretariat (LC Paper No. <a href="#">CB(1)1034/14-15(07)</a>)</p> <p>Minutes of meeting (LC Paper No. <a href="#">CB(1)1258/14-15</a>)</p>

<b>Date</b>	<b>Event</b>	<b>Paper</b>
20 January 2016	The Inland Revenue (Amendment) Bill 2016 was introduced into the Legislative Council	<a href="#">The Bill</a>  Legislative Council Brief ( <a href="#">File Ref: TsyB R 183/700-6/7/0 (C)</a> )  Legal Service Division Report (LC Paper No. <a href="#">LS28/15-16</a> )
February to May 2016	Bills Committee on Inland Revenue (Amendment) Bill 2016	Background brief prepared by the Legislative Council Secretariat (LC Paper No. <a href="#">CB(1)518/15-16(03)</a> )  Report of the Bills Committee (LC Paper No. <a href="#">CB(1)984/15-16</a> )
2 November 2016	The Inland Revenue Ordinance (Amendment of Schedule 17E) Notice 2016 was tabled at the Legislative Council meeting	<a href="#">The Amendment Notice</a>  Legislative Council Brief ( <a href="#">File Ref: TsyB R 183/700-6/7/0 (C)</a> )  Legal Service Division Report (LC Paper No. <a href="#">LS7/16-17</a> )