

For discussion
on 16 March 2017

Legislative Council Panel on Financial Affairs

Update on Implementation of Automatic Exchange of Financial Account Information in Tax Matters (“AEOI”)

Purpose

This paper briefs Members of Government’s latest strategy for implementing AEOI in Hong Kong in response to new international developments. The revised strategy aims to avoid the risk of Hong Kong being listed as a “non-cooperative tax jurisdiction”.

Implementation of AEOI in Hong Kong

2. The Organisation for Economic Co-operation and Development (“OECD”) promulgated the new international standard for AEOI in July 2014 with a view to enhancing tax transparency and combating cross-border tax evasion. In September 2014, Hong Kong indicated its support for implementing AEOI on a bilateral basis with appropriate partners with a view to commencing the first exchanges by the end of 2018. So far, 100 jurisdictions have signed up for this global initiative.

3. We amended the Inland Revenue Ordinance (“IRO”) in June 2016 to put in place a legal framework for implementing AEOI. A financial institution (“FI”)¹ is required to-

- (a) conduct due diligence procedures to identify financial accounts held by tax residents of “reportable jurisdictions” (i.e. jurisdictions with which Hong Kong will conduct AEOI, as specified in Part 1 of Schedule 17E to the IRO);

¹ FIs are defined in the IRO to mean custodial institutions, depository institutions, investment entities and specified insurance companies. They principally refer to banks, securities firms, insurance companies and investment funds.

- (b) collect the required information in relation to these reportable accounts (i.e. the **targeted approach**); and
- (c) furnish the IRD with such information from a specified reporting year for onward exchange with the relevant AEOI partner.

The IRO also allows an FI to apply the stipulated procedures to identify and collect the required information in respect of accounts held by tax residents of jurisdictions outside Hong Kong² (i.e. the **wider approach**) though it is not a mandatory requirement. The adoption of a targeted approach for FIs to collate account information primarily aims to minimise the compliance burden for FIs.

4. After establishing the legal framework for implementing AEOI, we have signed bilateral Competent Authority Agreements (“BCAAs”) with Japan and the United Kingdom respectively for conducting AEOI starting from 2018. Both jurisdictions, being **confirmed** AEOI partners of Hong Kong, have been included in the list of “reportable jurisdictions” in Part 1 of Schedule 17E to the IRO, so that FIs can conduct their due diligence and data collection accordingly. In October 2016, Hong Kong indicated that it will expand its AEOI network to cover all our tax treaty partners³ committed to adopting AEOI, and IRD has approached them for BCAA discussions. In January 2017, we signed a BCAA with Korea for conducting AEOI starting from 2019.

New developments

5. The international community has been closely monitoring jurisdictions’ progress in the implementation of AEOI and putting emphasis on a wide network of AEOI to ensure a level-playing field.

² Or in respect of accounts held by passive NFEs (as defined in the IRO) whose controlling persons are tax residents of jurisdictions outside Hong Kong.

³ Hong Kong’s tax treaty partners refer to jurisdictions with which Hong Kong has signed comprehensive avoidance of double taxation agreements (“CDTAs”) or tax information exchange agreements (“TIEAs”). At present, Hong Kong has 44 tax treaty partners, including 37 CDTA partners and 7 TIEA partners. Among them, 39 have committed to adopting AEOI. The five exceptions are: Belarus, Pakistan, Thailand, the United States and Vietnam.

While Hong Kong is on its way to commencing the first automatic exchanges with two jurisdictions in 2018, both the OECD and the European Union (“EU”) have kicked off their respective exercises to draw up lists of “non-cooperative tax jurisdictions”. At the Leaders’ Summit in Hangzhou in September 2016, G20 Leaders endorsed the three criteria proposed by the OECD for identifying non-cooperative tax jurisdictions. A jurisdiction would be considered “non-cooperative” if it fails to meet the benchmarks of **at least two of the following three criteria** –

- (a) exchange of information on request (“EOIR”) - obtain at least a rating of "Largely Compliant" from the Global Forum on Transparency and Exchange of Information for Tax Purposes (“Global Forum”);
- (b) AEOI - first exchanges commence in 2018 (with respect to the **financial account information for the year 2017**) at the latest; and
- (c) the Convention on Mutual Administrative Assistance in Tax Matters (“Multilateral Convention”) - participation in the Multilateral Convention or a sufficiently broad exchange network permitting both EOIR and AEOI.

6. The EU endorsed in November 2016 three criteria for its screening exercise. A jurisdiction could be regarded by EU as compliant on tax transparency if it fulfils **at least two of the following three criteria-**

- (a) AEOI - arrangement in place for exchange with **all Member States of EU by end 2017**, either by signing the Multilateral Competent Authority Agreement or through bilateral agreements (and in future obtain at least a rating of "Largely Compliant" from the Global Forum);
- (b) EOIR - obtain at least a rating of “Largely Compliant” from Global Forum; and
- (c) the Multilateral Convention - participation in the Multilateral Convention, or having a network of agreements covering **all Member States of EU** (allowing both EOIR and AEOI),

either already in force or expected to enter into force within a reasonable time frame.

7. A considerable number of jurisdictions have indicated to OECD their interest in conducting AEOI with Hong Kong. If we do not have arrangements in place for AEOI with them or with EU Member States by the end of 2017, Hong Kong could risk being labelled as “non-cooperative”.

8. In view of the latest developments, Hong Kong needs to expand our AEOI network quickly so as to preserve information covering the period starting from the second half of 2017 for exchange. A jurisdiction listed as “non-cooperative” could be subject to **counter-measures** which would make it a less attractive place for investment and business. Such counter-measures might include the imposition of withholding taxes and non-deductibility of costs of transactions by other jurisdictions.

Constraints for Expanding Hong Kong’s AEOI Network

9. While Hong Kong has pledged to expand its network of AEOI to cover all our tax treaty partners committed to adopting AEOI, and has approached them for BCAA discussions, we face two key constraints in the negotiations because -

- (a) BCAA discussions with individual jurisdictions would take time. In many cases, our bilateral tax treaties (i.e. CDTAs and TIEAs) would need to be amended to allow for AEOI.
- (b) FIs are currently mandated to take the targeted approach only, i.e. identify and collect information in relation to accounts held by tax residents of **confirmed** AEOI partners as included in the list of “reportable jurisdictions” in the IRO. FIs have no obligation to do the same in respect of tax residents of a **prospective** AEOI partner, and this makes it difficult for Hong Kong to exchange back-year data (i.e. account information from 1 January 2017 until the time a jurisdiction becomes a reportable jurisdiction) with jurisdictions who become our

AEOI partner in the future. Since only confirmed AEOI partners would be included in the list of reportable jurisdictions, the current list only contains two jurisdictions⁴. The targeted approach coupled with a list of handful “reportable jurisdictions” could lead to “information loss” as raised by some of our treaty partners. The EU is particularly keen on receiving data with respect to 2017 and would like to get data **at least for the period commencing 1 July 2017**.

10. To overcome the above challenges and to expand our AEOI network speedily, we consider it important for Hong Kong to amend the IRO so as to mandate FIs to identify and collect information in relation to accounts held by tax residents of **prospective** AEOI partners, in addition to confirmed AEOI partners, of Hong Kong.

Legislative Proposal

11. We propose to include 71 prospective AEOI partners and one confirmed AEOI partner (being Korea) as Hong Kong’s “reportable jurisdictions”, on top of the two already included in the list (i.e. Japan and the United Kingdom), with effect from 1 July 2017 (see **Annex**). The 71 prospective AEOI partners are from the following three categories –

- (a) jurisdictions which expressed an interest to OECD in late 2016 in conducting AEOI with Hong Kong;
- (b) Hong Kong’s tax treaty partners which have committed to AEOI; and
- (c) all Member States of the EU.

The proposal is meant to take effect from **1 July 2017**. This means that all FIs would be obliged from that day onwards to identify and collect information on accounts of tax residents in 74 jurisdictions (72 new + Japan and the United Kingdom).

⁴ Whilst Korea (with which Hong Kong has already signed a BCAA) is also a confirmed AEOI partner, it has yet to be included in the list of reportable jurisdictions. We plan to include Korea together with 71 prospective AEOI partners in the list of reportable jurisdictions in one go.

12. Whilst the data collection obligation starts from 1 July 2017, the “reporting year” in the proposed new schedule will be “2018”. In practice, IRD will call on the FIs to submit the relevant data by May 2018, so that after consolidation, IRD can conduct the exchange in September 2018 for jurisdictions which have by then signed BCAAs with Hong Kong in accordance with the OECD requirement. We would like to emphasize that exchange will be conducted only with a reportable jurisdiction when a CDTA / TIEA (having effect under section 49(1A) of the IRO) is in place to provide the basis for exchange, together with a BCAA signed on that basis for conducting AEOI.

13. For the **first round of reporting** in 2018, FIs will be asked to furnish, for the 72 newly-added reportable jurisdictions, data with respect to the period from 1 July to 31 December 2017, whereas for Japan and the United Kingdom, data with respect to the period from 1 January 2017 to 31 December 2017. In **subsequent years**, FIs are expected to furnish IRD with full-year data for all jurisdictions included as “reportable jurisdictions”. This would help ease the compliance burden on FIs by sparing their need to collect past information for individual jurisdictions at different points in time whenever Hong Kong enters in AEOI with a new jurisdiction and the back-year data could be efficiently collated and stored. The information so reported to IRD would be exchanged with the jurisdiction concerned **only after** an AEOI agreement with the necessary data protection safeguards has been put in place.

Engagement with Stakeholders

14. To take the matter forward, we issued an information note to our stakeholders, including key FI groups, regulators, professional associations and business chambers in mid-February 2017 to update them of the latest international developments and Government’s revised implementation strategy. A briefing session for the stakeholders was also held on 3 March 2017.

15. In general, our stakeholders understood the latest international developments on AEOI and supported Hong Kong’s continued commitments in the implementation of this international drive. At the

same time, there were concerns about the implementation timetable of AEOI in Hong Kong, such as the timing for FIs to furnish returns on reportable accounts and the timeline for IRD to exchange information with other jurisdictions. We assured our stakeholders that, while FIs would be required to collect information on tax residents of more jurisdictions, IRD would only exchange such information with those jurisdictions upon the signing of the relevant AEOI agreements.

16. To enhance the awareness of the general public on AEOI and to facilitate FIs' work, a television and radio Announcement in the Public Interest has been broadcast since December 2016 and posters were produced for FIs' deployment. We will continue our close liaison with stakeholders in ensuring a smooth implementation of the proposed revised AEOI requirements.

Related Matters

17. Apart from seeking to expand the list of "reportable jurisdictions" to cover prospective AEOI partners of Hong Kong, we will also seek to conclude AEOI agreements with more jurisdictions on a bilateral basis⁵. At present, Hong Kong is not covered by the Multilateral Convention, which provides a basis for jurisdictions to conduct AEOI on a multilateral basis. We note that, for those 100 jurisdictions committed to AEOI, over 90 have participated in the Multilateral Convention (either as a signatory or as a territory covered by way of territorial extension). We are now considering the possibility of seeking the application of the Multilateral Convention to Hong Kong for the conduct of AEOI. We will keep stakeholders informed of the progress in this regard. Indeed, as illustrated in paragraphs 5 and 6 above, participation in the Multilateral Convention is one of the three assessment criteria for OECD and EU in identifying "non-cooperative tax jurisdictions".

⁵ It has been Hong Kong's intention to conduct AEOI on a bilateral basis with our tax treaty partners. However, among the 100 jurisdictions that have committed to AEOI, so far only six jurisdictions have planned to implement AEOI on a bilateral basis.

Way Forward

18. Given the upcoming review by OECD and EU on Hong Kong's progress in the implementation of AEOI, we plan to introduce an amendment bill into the Legislative Council in late March or April 2017 to effect the above proposal, with a view to having it in place by 1 July 2017. This tight work plan is crucial for meeting the aspiration of OECD and EU for maintaining data from the second half of 2017 for exchange with other jurisdictions in due course.

**The Treasury Branch
Financial Services and the Treasury Bureau
March 2017**

Proposed Revised List of Reportable Jurisdictions of Hong Kong

- | | |
|--|---------------------------------------|
| 1. Antigua and Barbuda | 38. Italy [@] |
| 2. Argentina | 39. Japan ^{@#} |
| 3. Australia | 40. Jersey [@] |
| 4. Austria [@] | 41. Korea ^{@*} |
| 5. Bahamas | 42. Kuwait [@] |
| 6. Belgium [@] | 43. Latvia [@] |
| 7. Brazil | 44. Lebanon |
| 8. Brunei Darussalam [@] | 45. Liechtenstein [@] |
| 9. Bulgaria | 46. Lithuania |
| 10. Canada [@] | 47. Luxembourg [@] |
| 11. Cayman Islands | 48. Malaysia [@] |
| 12. Chile | 49. Malta [@] |
| 13. The Mainland of China [@] | 50. Mauritius |
| 14. Colombia | 51. Mexico [@] |
| 15. Costa Rica | 52. Montserrat |
| 16. Croatia | 53. Netherlands [@] |
| 17. Curacao | 54. New Zealand [@] |
| 18. Cyprus | 55. Norway [@] |
| 19. Czech Republic [@] | 56. Poland |
| 20. Denmark [@] | 57. Portugal [@] |
| 21. Estonia | 58. Qatar [@] |
| 22. Faroe Islands [@] | 59. Romania [@] |
| 23. Finland | 60. Russia [@] |
| 24. France [@] | 61. Saint Vincent and the Grenadines |
| 25. Germany | 62. Saudi Arabia |
| 26. Gibraltar | 63. Seychelles |
| 27. Greece | 64. Singapore |
| 28. Greenland [@] | 65. Slovak Republic |
| 29. Grenada | 66. Slovenia |
| 30. Guernsey [@] | 67. South Africa [@] |
| 31. Hungary [@] | 68. Spain [@] |
| 32. Iceland [@] | 69. Sweden [@] |
| 33. India | 70. Switzerland [@] |
| 34. Indonesia [@] | 71. United Arab Emirates [@] |
| 35. Ireland [@] | 72. United Kingdom ^{@#} |
| 36. Isle of Man | 73. Uruguay |
| 37. Israel | 74. Vanuatu |

[#] Confirmed AEOI partner already included in the existing list of reportable jurisdictions

^{*} Confirmed AEOI partner not yet included in the existing list of reportable jurisdictions

[@] Hong Kong's existing tax treaty partners committed to AEOI (as at 9 March 2017)