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Panel on Financial Affairs

Meeting on 5 June 2017

**Updated background brief on
automatic exchange of information for tax purposes**

Purpose

This paper provides background information on the implementation of automatic exchange of financial account information in tax matters ("AEOI") in Hong Kong, and summarizes the views and concerns expressed by Members when related issues were discussed by relevant committees of the Legislative Council ("LegCo") since the 2014-2015 legislative session.

Background

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

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"). In September 2014, Hong Kong indicated its support for implementing AEOI on a reciprocal 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. The Government's policy is 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 mechanism.¹ 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 before the exchange of the relevant information takes place.

4. To provide for the legal framework for implementing AEOI in Hong Kong, the Government amended the Inland Revenue Ordinance (Cap. 112) ("IRO") in June 2016 ("the Amendment Ordinance 2016").² The Amendment Ordinance 2016 has added a new section 50J to IRO empowering the Secretary for Financial Services and the Treasury to amend, among others, Schedule 17E to IRO to provide for a list of reportable jurisdictions. 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).

5. Moreover, financial institutions ("FIs") are required to conduct due diligence procedures to identify reportable accounts held by tax residents³ of confirmed AEOI partners as included in the list of reportable jurisdictions and collect the required information in respect of these reportable accounts.⁴ FIs are also required to furnish such information to IRD from a specified reporting year for onward exchange with the relevant AEOI partners.

¹ Comprehensive avoidance of double taxation agreements are tax agreements which seek to minimize incidence of double taxation between the contracting parties and provide a mechanism for the exchange of information ("EOI") between tax authorities, whereas tax information exchange agreements serve as EOI instruments without offering any taxation relief.

² The Legislative Council ("LegCo") passed the Inland Revenue (Amendment) (No. 3) Ordinance 2016 on 22 June 2016 which came into effect on 30 June 2016.

³ In general, whether or not an individual is a tax resident of a jurisdiction is determined by having regard to the person's physical presence or stay in a place (e.g. whether over 183 days within a tax year) or, in the case of a company, the place of incorporation or where the central management or control of the entity lies.

⁴ Under section 50A of the Inland Revenue Ordinance (Cap. 112), "financial institution ("FI")" means (a) a custodial institution; (b) a depository institution; (c) an investment entity; or (d) a specified insurance company. For the purpose of implementing automatic exchange of financial account information in tax matters ("AEOI") in Hong Kong, only FIs which are resident in Hong Kong will be subject to the reporting requirements.

6. Since enactment of the Amendment Ordinance 2016, IRD has signed bilateral CAAs with 11 jurisdictions. Implementation of AEOI with Japan and the United Kingdom ("UK") will commence from 2018. Both jurisdictions have been included in the list of reportable jurisdictions in Part 1 of Schedule 17E to IRO.⁵ The remaining nine jurisdictions, namely Belgium, Canada, Guernsey, Italy, Korea, Mexico, the Netherlands, Portugal and South Africa, have yet to be included in the list of reportable jurisdictions.

Expansion of Hong Kong's network for the implementation of automatic exchange of financial account information in tax matters

7. 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. Both OECD⁶ and the European Union ("EU")⁷ have kicked off their respective exercise to draw up lists of "non-cooperative tax jurisdictions". One of the listing criteria is the progress and the network of implementing AEOI. The Government has

⁵ The Inland Revenue Ordinance (Amendment of Schedule 17E) Notice 2016 was tabled before LegCo on 2 November 2016 to, among other things, add Japan and the United Kingdom in the list of reportable jurisdictions. The relevant provisions came into operation on 31 December 2016.

⁶ A jurisdiction would be considered by the Organisation for Economic Co-operation and Development ("OECD") as "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.

⁷ A jurisdiction could be regarded by the European Union ("EU") as compliant on tax transparency if it fulfills 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.

emphasized the importance for Hong Kong to take timely action in response to the mounting aspirations of OECD and EU for preserving data from the second half of 2017 for exchange with other jurisdictions so as to avoid being listed as "non-cooperative tax jurisdictions", which could then be subject to counter-measures including the imposition of withholding taxes.

Inland Revenue (Amendment) (No.3) Bill 2017

8. Hong Kong faces constraints in the negotiations of CCA because such discussions with individual jurisdictions take time, and in many cases, Hong Kong's bilateral tax treaties (i.e. CDTAs or TIEAs) will need to be amended to allow for AEOI. Moreover, FIs are currently mandated to identify and collect information in relation to accounts held by tax residents of confirmed AEOI partners as included in the list of reportable jurisdictions only. To overcome the above challenges, the Government introduced the Inland Revenue (Amendment) (No.3) Bill 2017⁸ ("the Amendment Bill 2017") into LegCo in March 2017 to amend Part 1 of Schedule 17E to IRO to add 63 prospective⁹ AEOI partners and nine confirmed AEOI partners (see paragraph 6) on top of Japan and the UK to the list of reportable jurisdictions¹⁰ with 2018 as the reporting year.

9. LegCo has formed the Bills Committee on Inland Revenue (Amendment) (No.3) Bill 2017 to study the Amendment Bill. The Bills Committee has completed its work and the Second Reading debate on the Amendment Bill 2017 is scheduled to resume at the Council meeting of 7 June 2017. The Amendment Bill 2017, if passed, will come into operation on 1 July 2017.

⁸ The Inland Revenue (Amendment) (No.3) Bill 2017 has received its First Reading at the LegCo meeting of 29 March 2017.

⁹ The 63 prospective AEOI partners are from the following three categories:

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

¹⁰ The Government has proposed a Committee Stage amendment ("CSA") to add "Republic of Turkey" as a reportable jurisdiction as OECD has recently suggested that Hong Kong should consider including Turkey, being a member of Group Twenty, as its AEOI partner. With the proposed CSA, all members of Group of Twenty participating in AEOI will be on the list of reportable jurisdictions of Hong Kong.

Convention on Mutual Administrative Assistance in Tax Matters

10. At present, Hong Kong is not covered by the Convention on Mutual Administrative Assistance in Tax Matters ("Multilateral Convention"), which provides a basis for jurisdictions to conduct AEOI on a multilateral basis. According to the Government, for the 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). Indeed, participation in the Multilateral Convention is one of the three assessment criteria for OECD and EU in identifying "non-cooperative tax jurisdictions".¹¹ In view of the mounting pressure for jurisdictions to conduct AEOI on a multilateral basis (as against a bilateral approach which Hong Kong has adopted), the Government has been reviewing the relevant strategy, including considering the possibility of seeking the application of the Multilateral Convention to Hong Kong for the conduct of AEOI.

Major views and concerns expressed by Members

11. Matters relating to the implementation of the AEOI regime in Hong Kong were discussed at the meetings of the Panel on Financial Affairs ("FA Panel") on 3 November 2014, 6 July 2015 and 16 March 2017, the Bills Committee on Inland Revenue (Amendment) Bill 2016, the Finance Committee during examination of the Estimates of Expenditure 2015-2016 on 30 March 2015, the Subcommittee on Inland Revenue Ordinance (Amendment of Schedule 17E) Notice 2016 and the Bills Committee on Inland Revenue (Amendment) (No.3) Bill 2017. The major views and concerns expressed by Members at 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 for Hong Kong to pursue AEOI given its territorial-based tax regime. These Members cautioned that following the international standards of AEOI indiscriminately and too closely might risk eroding the edges of simple tax regime and flexible business environment of Hong Kong in the long run.

¹¹ See footnotes 6 and 7.

13. The Government advised that the international community had 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. Both OECD and EU had kicked off their respective exercises to draw up lists of "non-cooperative" tax jurisdictions. One of the listing criteria was the progress and the network of implementing AEOI. In the case of EU, a jurisdiction could be regarded as compliant on tax transparency if it fulfilled certain criteria, one of which was that arrangements had been in place for AEOI with all EU Member States by end 2017. A considerable number of jurisdictions had also indicated to OECD their interest in conducting AEOI with Hong Kong.

Operational arrangements for automatic exchange of information with reportable jurisdictions

14. Members noted that reporting FIs should start conducting due diligence procedures and collect 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. FIs should lodge the AEOI returns within five months after the calendar year to which the information related and IRD would then commence the first information exchange with the tax authorities of the reportable jurisdictions in the following September (and September annually thereafter). Given the bulk of information involved, Members enquired about the feasibility of spreading out the deadlines for FIs to submit the AEOI returns in respect of different jurisdictions over different months of a reporting year.

15. The Government responded that the automatic exchange of information among tax authorities in September each year was a common timeframe for all reportable jurisdictions. To meet this timeframe, FIs would be required to submit their AEOI returns to IRD by May in the reporting year concerned. OECD would put in place a Common Transmission System for exchange of information among tax authorities. At the domestic level, IRD would put in place a secure platform, i.e. the AEOI Portal, for FIs to submit notifications and file returns on required information of reportable accounts electronically. It was envisaged that with this new electronic platform in place, the processing and exchange of data would not create too much administrative burden on IRD.

Due diligence procedures

16. Members were concerned that the surge in the number of reportable jurisdictions after the enactment of the Amendment Bill 2017 might create undue compliance burden on FIs in carrying out the due diligence procedures in verifying reportable financial accounts. Members enquired about how reporting

FIs would be taken as having exercised all reasonable due diligence to identify the tax residences of account holders. Some Members considered that the Government should adopt a lenient approach in handling non-compliances of reporting FIs at the initial stage of AEOI implementation.

17. The Government advised that the essential requirements of OECD's AEOI standard, including the obligations on FIs to establish, maintain and apply due diligence procedures in respect of new accounts and pre-existing accounts, had already been included in IRO. Besides, under the existing Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615) ("AMLO"), FIs were required to conduct due diligence for their customers, so as to identify and verify the customers' identity. In order to reduce the compliance burden of FIs in carrying out the due diligence procedures for AEOI, FIs might resort to information collected pursuant to the AMLO procedures in performing the relevant due diligence requirements under the AEOI regime.

18. The Government further pointed out that FIs would be taken as having exercised reasonable due diligence to identify the tax residences of account holders so long as they had followed the relevant requirements in IRO. Self-certification by account holders would be an important tool for reporting FIs to fulfil their reporting and due diligence obligations, in particular to determine the tax residences of account holders. Should any information provided by the account holders be apparently in conflict with the information held by FIs, the FIs should seek new self-certification or explanation from the account holders. 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 on the due diligence and reporting requirements.

19. On the concern that the general public might not be familiar with how to ascertain their tax residences in relation to AEOI, the Government 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.

Safeguards to protect taxpayers' privacy and confidentiality of information exchanged

20. Members noted that Hong Kong would only exchange information with a reportable jurisdiction when a CDTA/TIEA was in place together with a bilateral CAA signed with the jurisdiction on that basis for conducting AEOI.

Members enquired how the privacy of personal data would be protected in implementing AEOI including measures to safeguard against misuse of information by Hong Kong's AEOI partners, and the penalties, if any, on IRD staff for leaking information in the course of handling AEOI data.

21. The Government emphasized that Hong Kong would only conduct AEOI with jurisdictions which had signed dedicated exchange agreements with Hong Kong and fulfilled OECD's standard and the relevant safeguards for protecting data privacy and confidentiality of the information exchanged. The scope and use of information to be exchanged followed the Common Reporting Standard of AEOI set by OECD strictly, and the Amendment Bill 2017 did not alter the privacy and data protection requirements on AEOI in IRO and at the treaty level. The Government stressed that OECD and the international community at large reckoned the importance and benefits of adhering to the safeguard provisions for the effective implementation of AEOI. OECD would continue to monitor jurisdictions' progress in this regard. At the domestic level, the Government had kept the Office of the Privacy Commissioner for Personal Data informed of the AEOI initiative and would ensure compliance with the relevant requirements in confidentiality and personal data privacy.

22. As regards the handling of AEOI data by IRD staff, the Government advised that there were established procedures on appointment or authorization of persons to carry out duties including AEOI arrangements under IRO. By virtue of sections 4(1) and 81(1)(b) of IRO, returns containing the required information furnished to IRD by FIs were subject to official secrecy protection, contravention of which constituted an offence. Non-compliances with the official secrecy provisions would also be followed up in accordance with the established civil service disciplinary mechanism. Furthermore, the information from FIs would be transmitted via IRD's AEOI Portal system and stored in the IRD's back-end system with encryption under a high level of security. The data would be stored in a dedicated database and would not be commingle. Stringent controls were put in place to restrict data access to a limited number of IRD officers after proper authentication. All data access would be logged and subject to review. IRD would only extract the information in respect of confirmed AEOI partners and exchange it with the partners concerned. The Government further advised that the Expert Panel team from the OECD Global Forum on Transparency and Exchange of Information for Tax Purposes conducted an on-site examination at IRD in April 2016, and considered that Hong Kong had put in place the key risk management processes and adequate controls in relation to AEOI.

23. Noting that the Government was considering the possibility of seeking the application of the Multilateral Convention to Hong Kong for conducting

AEOI, Members sought clarification on whether the Amendment Bill 2017 could enable the implementation of AEOI in Hong Kong on a multilateral basis in the future. The Government replied in the negative and advised that if the application of Multilateral Convention was extended to Hong Kong, it would necessitate another set of legislative amendments to IRO.

Latest development

24. The Government will update members on the application of the Multilateral Convention in Hong Kong at the FA Panel meeting on 5 June 2017.

Relevant papers

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

Council Business Division 1
Legislative Council Secretariat
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List of relevant papers

Date	Event	Paper
3 November 2014	Meeting of the FA Panel	Administration's paper (LC Paper No. CB(1)122/14-15(03)) Background brief (LC Paper No. CB(1)122/14-15(04)) Minutes (paragraphs 38-51) (LC Paper No. CB(1)379/14-15)
30 March 2015	Special meetings of the Finance Committee to examine the Estimates of Expenditure 2015-16 (session on public finance)	Speaking note of the Secretary for Financial Services and the Treasury Report on the examination of the Estimates of Expenditure 2015-2016
6 July 2015	Meeting of the FA Panel	Administration's paper (LC Paper No. CB(1)1034/14-15 (06)) Updated background brief (LC Paper No. CB(1)1034/14-15 (07)) Minutes (paragraphs 54-64) (LC Paper No. CB(1)1258/14-15)
22 June 2016	The Legislative Council passed the Inland Revenue (Amendment) Bill 2016	Hansard The Bill passed Report of the Bills Committee (LC Paper No. CB(1)984/15-16)

Date	Event	Paper
2 November 2016	Subcommittee on Inland Revenue Ordinance (Amendment of Schedule 17E) Notice 2016	Report (LC Paper No. CB(1)281/16-17)
16 March 2017	Meeting of the FA Panel	Administration's paper (LC Paper No. CB(1)660/16-17 (09)) Updated background brief (LC Paper No. CB(1)660/16-17 (10))
29 March 2017	Bills Committee on Inland Revenue (Amendment) (No.3) Bill 2017	Report (LC Paper No. CB(1)1008/16-17)