

Subcommittee on Inland Revenue (Exchange of Information relating to Taxes) (United States of America) Order

Follow-up to the meeting on 13 May 2014

Purpose

At the meeting held on 13 May 2014, Members raised a number of questions on the tax information exchange agreement (“TIEA”) between Hong Kong and the United States of America (“the US”) as well as the interface with the implementation of the US Foreign Account Tax Compliance Act (“FATCA”). This paper sets out the Administration’s consolidated responses to the questions.

Entering into a TIEA with the US

2. As we explained at the Subcommittee meeting on 13 May 2014, while it remains our policy priority to expand Hong Kong’s network of comprehensive avoidance of double taxation agreements (“CDTAs”), according to the prevailing international standard, a jurisdiction should make available both CDTA and TIEA as instruments for exchange of information (“EoI”) with other jurisdictions. In this connection, we amended the Inland Revenue Ordinance (Cap. 112) (“IRO”) in July 2013 to provide for a legal framework for Hong Kong to enter into TIEAs with other jurisdictions where necessary.

3. It is also the prevailing international standard that preference for a CDTA over a TIEA cannot be a reason for refusing to enter into an EoI agreement with relevant partners. Hence, while we have repeatedly persuaded those jurisdictions which approached us for TIEA negotiations to pursue CDTAs with Hong Kong instead, we have no alternative but to commence TIEA negotiations with them if they express no interest in our counter-proposal. The US is a case in point.

Scope of TIEA

4. In terms of the scope of a TIEA, there is limited room for individual jurisdictions to make adjustments since there is a model

agreement developed by the Organisation for Economic Cooperation and Development (“OECD”). The EoI mechanism provided for under the OECD’s model TIEA includes all information relating to taxes covered, which may or may not be held by financial institutions. Any major deviations from the model agreement, e.g. limiting the scope of information to be exchanged to information held by financial institutions only, will run the risk of the TIEA not being internationally regarded as a compliant EoI agreement. This will reflect badly on the image of Hong Kong as a cooperative jurisdiction.

5. Practically speaking, it is also highly unlikely that our TIEA partners (including the US) will agree to adopt a formulation distinct from the OECD’s model agreement. Our research reveals that the 33 TIEAs signed by the US with other jurisdictions (as listed at **Annex A**) generally follow the international standard, i.e. allowing for exchange of information from various sources.

Interface with FATCA

6. Entering into a TIEA with the US serves the primary purpose of fulfilling Hong Kong’s international obligation in enhancing tax transparency. FATCA is no more than a catalyst. To facilitate compliance with FATCA by the financial institutions in Hong Kong, it serves Hong Kong’s interest to enter into an Intergovernmental Agreement (“IGA”) with the US, which needs to be underpinned by an EoI agreement (be it CDTA or TIEA). To facilitate the early conclusion of the IGA with the US before the imminent implementation of FATCA in July 2014, there is thus a need for Hong Kong to put in place a TIEA with the US in a timely manner.

7. Details about FATCA and Hong Kong’s IGA with the US are set out at **Annex B**.

Operation of the HK/US TIEA

8. Same as other jurisdictions, Hong Kong largely adopts the OECD’s model TIEA (2002 version) as the basis for negotiating TIEAs with other jurisdictions (including the US). In the HK/US TIEA, there

are certain modifications to address either the US' comments or our local needs, which are permissible under the commentary of the OECD model. A comparison of the HK/US TIEA with the OECD model TIEA is at **Annex C**.

9. Under the HK/US TIEA, the US' competent authority may lodge EoI requests to Hong Kong Inland Revenue Department ("IRD") where necessary. The actual operation of the EoI mechanism under the HK/US TIEA will essentially be the same as that under CDTAs. Specifically, upon receipt of an EoI request from the US, IRD will examine, with reference to the particulars provided by the US, whether the information requested is foreseeably relevant according to the conditions laid down in the HK/US TIEA and in the Inland Revenue (Disclosure of Information) Rules (Cap. 112BI). If the conditions are not fulfilled, IRD will not approve the EoI request. For a valid EoI request, IRD will collect the requested information by issuing formal notices to relevant persons under the IRO.

10. When the requested information is gathered, IRD will notify in writing the person who is the subject of the request (including the taxpayer concerned even if the information requested is in possession by a third party) of the nature of the information requested by the US tax authority and of his right to request within 14 days after the date of notification a copy of the information that IRD is prepared to disclose to the US. Within 21 days after IRD provides a copy of the information to be disclosed, the relevant person can ask IRD to amend any part of the information on the grounds that the information is factually incorrect or does not relate to him. The Commissioner of Inland Revenue ("CIR") may make full amendment, partial amendment or no amendment. If the person remains not satisfied, he can within 14 days after CIR's notice of decision further ask the Financial Secretary to direct CIR to make the amendments requested. Upon completion of the above procedures, IRD will then issue a final reply to the US on the EoI request.

Annex A**TIEAs signed by the US**

	Jurisdiction	Signature Date
1.	Hong Kong	25.03.2014
2.	Mauritius	27.12.2013
3.	Cayman Islands	29.11.2013
4.	Panama	30.11.2010
5.	Monaco	08.09.2009
6.	Gibraltar	31.03.2009
7.	Liechtenstein	08.12.2008
8.	Brazil	20.03.2007
9.	Aruba	21.11.2003
10.	Jersey	04.11.2002
11.	Isle of Man	03.10.2002
12.	Guernsey	19.09.2002
13.	Netherlands Antilles	17.04.2002
14.	British Virgin Islands	03.04.2002
15.	Bahamas	25.01.2002
16.	Antigua and Barbuda	06.12.2001
17.	Colombia	30.03.2001
18.	Guyana	22.07.1992
19.	Marshall Islands	14.03.1991
20.	Honduras	27.09.1990
21.	Peru	15.02.1990
22.	Mexico	09.11.1989
23.	Dominican Republic	07.08.1989
24.	Puerto Rico	26.05.1989
25.	Costa Rica	15.03.1989
26.	Trinidad and Tobago	11.01.1989
27.	Bermuda	02.12.1988
28.	American Samoa	10.12.1987
29.	Dominica	01.10.1987
30.	St. Lucia	30.01.1987
31.	Grenada	18.12.1986
32.	Jamaica	18.12.1986
33.	Barbados	03.11.1984

Information on FATCA and the IGA with the US

In response to the Subcommittee's request, this Annex sets out relevant information in relation to an IGA reached in substance between Hong Kong and the US that will facilitate compliance with the FATCA by financial institutions in Hong Kong.

Background

2. Enacted by the US Congress as part of the US Hiring Incentives to Restore Employment Act 2010, FATCA is an anti-tax evasion regime enacted by the US to detect US taxpayers¹ who use accounts with non-US financial institutions (i.e. "foreign financial institution", or "FFIs", in FATCA parlance) to conceal income and assets from the US Internal Revenue Service ("IRS"). FATCA requires FFIs to report financial account information of US taxpayers to the US IRS. Failing to comply with the reporting requirements under FATCA will result in the US Government imposing a 30% withholding tax on certain gross payments made from the US to non-compliant FFIs.

Models 1 and 2 IGAs

3. The US has developed two Model IGAs to simplify the FATCA requirements and overcome relevant jurisdiction-specific impediments in relation to FATCA implementation. A Model 1 IGA essentially requires FFIs to report account information of US taxpayers to their own government, which will in turn commit to exchanging such information at a government level with the US IRS on an automatic basis². A Model 2 IGA, which Hong Kong is pursuing, essentially requires FFIs to report the relevant account information of US taxpayers to the US IRS

¹ The due diligence and reporting requirements under FATCA will target specified US taxpayers including US citizens, or US resident individuals, or specified entities established in the US or controlled by US persons.

² As at 14 May 2014, 27 jurisdictions have signed a Model 1 IGA with the US. They include Australia, Belgium, Canada, Cayman Islands, Costa Rica, Denmark, Estonia, Finland, France, Germany, Gibraltar, Guernsey, Hungary, Honduras, Ireland, Isle of Man, Italy, Jamaica, Jersey, Luxembourg, Malta, Mauritius, Mexico, the Netherlands, Norway, Spain and the United Kingdom. In addition, some 30 jurisdictions have reached a Model 1 agreement in substance with the US. They include Bahamas, Brazil, British Virgin Islands, Bulgaria, Colombia, Croatia, Curaçao, Czech Republic, Cyprus, India, Indonesia, Israel, Kosovo, Kuwait, Latvia, Liechtenstein, Lithuania, New Zealand, Panama, Peru, Poland, Portugal, Qatar, Romania, Singapore, Slovak Republic, Slovenia, South Africa, South Korea and Sweden.

directly, supplemented by requests made by the US IRS, on a need basis, for exchange of information on relevant US taxpayers at a government level³.

Hong Kong-US IGA

4. The financial industry in Hong Kong have expressed concerns on the onerous compliance requirements of FATCA without an IGA (see paragraph 6 below), and expects the Government to conclude an IGA with the US to facilitate their compliance work and seek maximum exemptions. In the light of this, Hong Kong and the US have entered into discussions and in May 2014 reached agreement in substance on a Model 2 IGA. We expect to sign the IGA later this year.

5. To reduce their FATCA compliance burdens pursuant to the IGA, FFIs in Hong Kong will need to register and conclude separate individual agreements (known as “FFI agreements”) with the US IRS. In this context, these FFIs include custodial institutions⁴, depository institutions⁵, investment entities⁶ or specified insurance companies⁷. Under these FFI agreements, FFIs in Hong Kong will use established due diligence procedures under the prevailing anti-money laundering legislation to identify account holders who are US taxpayers, and seek consent of these US account holders for reporting their account information to the US IRS annually.

³ As at 14 May 2014, five jurisdictions have signed a Model 2 IGA with the US. They include Austria, Bermuda, Chile, Japan and Switzerland. Two jurisdictions, including Armenia and Hong Kong, have reached a Model 2 agreement in substance with the US.

⁴ The term “custodial institution” means any entity that holds, as a substantial portion of its business, financial assets for the accounts of others. An entity holds financial assets for the account of others as a substantial portion of its business if the entity’s gross income attributable to the holding of financial assets and related financial services equals or exceeds 20% of the entity’s gross income during a relevant period.

⁵ The term “depository institution” means any entity that accepts deposits in the ordinary course of a banking or similar business.

⁶ The term “investment entity” means any entity that conducts as a business one or more of the following activities or operations for or on behalf of a customer –

- (a) trading in money market instruments; foreign exchange; exchange, interest rate and index instruments; transferable securities; or commodity futures trading;
- (b) individual and collective portfolio management; or
- (c) otherwise investing, administering, or managing funds or money on behalf of other persons.

⁷ The term “specified insurance company” means any entity that is an insurance company that issues, or is obligated to make payments with respect to, a cash value insurance contract or an annuity contract.

6. The IGA will reduce reporting burden and facilitate compliance of FATCA by financial institutions in the following ways –

- (a) FFIs in Hong Kong complying with the respective FFI Agreements will not be subject to the 30% withholding tax⁸ in respect of relevant US-sourced payments by institutions in the US or other relevant FFIs. This will help safeguard the interest of all depositors, insurance policy holders, investors and other clients of FFIs in Hong Kong;
- (b) The US IRS will waive the requirements under the relevant US Internal Revenue Code for FFIs in Hong Kong to withhold tax on payments to recalcitrant accounts (i.e. accounts of which the holders do not consent to FATCA reporting and disclosure to the US IRS) or close those recalcitrant accounts;
- (c) For group institutions with worldwide operations, their Hong Kong operations will continue to be treated as FATCA-compliant, despite any non-compliance of a related entity operated in a jurisdiction that prevents its compliance with FATCA;
- (d) FFIs in Hong Kong may rely on a set of streamlined due diligence procedures set out in the IGA to screen and identify US indicia in order to locate US accounts and clients for reporting purposes. This will minimise compliance burden of FFIs in Hong Kong and inconvenience for other account holders who are not the targets of FATCA; and
- (e) A wide range of entities, financial institutions and products (including, among others, the Government and all statutory bodies, mandatory provident fund schemes, other retirement products that fall within the specified criteria, institutions with a predominantly local clientele, credit unions, certain regulated collective investment schemes, investment advisers and investment managers, and certain employee incentive share schemes) shall be exempt in view of the low risks of

⁸ An FFI which does not sign an FFI Agreement or is not otherwise exempt will face a punitive 30% withholding tax on all “withholdable payments” derived from US sources, initially including dividends, interest and certain derivative payments. In addition, starting from 2017, gross proceeds such as sales proceeds and returns of principal derived from stocks and debt obligations generating US-sourced dividends or interest will be treated as “withholdable payments”.

themselves being used by US taxpayers for tax evasion.

Due Diligence Requirements for FFIs

7. The streamlined due diligence procedures contained in the IGA will allow FFIs in Hong Kong to apply different levels of due diligence depending on whether the account is held by a US individual or a US entity, and whether the account was opened prior to 1 July 2014⁹.

8. Broadly speaking, for preexisting individual accounts, no additional review, identification or reporting will be required if the balance or value of such individual accounts does not exceed US\$50,000¹⁰. For those preexisting individual accounts with a balance or value that exceeds US\$50,000 but below US\$1 million, FFIs in Hong Kong will need to review electronically searchable data maintained by the institutions for any “US indicia”¹¹ in order to identify US taxpayers. For preexisting individual accounts with a balance or value exceeding US\$1 million, apart from the electronic record search, FFIs will also be required to review customer files, including the most recent documentation obtained pursuant to the customer due diligence procedures under the existing anti-money laundering legislation or for other regulatory purposes, to identify US indicia. For new accounts opened after 1 July 2014, FFIs will require self-certification, which may be part of the account opening documentation, from clients to confirm whether the account holder will be a US resident for tax purposes.¹²

9. As long as FFIs in Hong Kong follow the due diligence requirements set out in the IGA and their own FFI Agreements with the

⁹ An account that was opened prior to 1 July 2014 is called “preexisting account” for FATCA purposes.

¹⁰ For an account that is a cash value insurance contract or an annuity contract, the threshold for this value or balance is US\$250,000.

¹¹ Examples of US indicia include any identification of the account holder as a US citizen or resident, any indication of a US place of birth, US mailing or residence address, US telephone numbers, standing instructions to transfer funds to an account maintained in the US, etc.

¹² Broadly speaking, as far as entity accounts are concerned, no due diligence is required under the IGA to identify any preexisting US entity account if the balance or value of the account does not exceed US\$250,000. For those entity accounts with a balance or value that exceeds US\$250,000, FFIs will be required to review information maintained for regulator or customer relationship purposes (including information collected pursuant to the anti-money laundering legislation for customer due diligence purposes) to determine whether the information indicates the holder of the entity account concerned is a US taxpayer. For other new accounts, FFIs will be required to obtain self-certification from the account holders to ascertain whether they are US taxpayers and their FATCA-compliant status.

US, they will be treated as complying with the requirements of FATCA and will not be subject to withholding. Financial institutions may leverage the current customer due diligence requirements under relevant anti-money laundering legislation, and build in additional appropriate and reasonable procedures if necessary, to ascertain the identity of clients including those who are US taxpayers.

Engagement with the Financial Services Industry

10. The Government has been engaging the financial services industry intensively in the discussions with the US authorities, and is grateful to relevant trade bodies in the financial markets for their inputs, especially for the exemptions required to facilitate their operation and compliance. We announced by a press release the completion of the substantive discussions with the US on the IGA on 9 May 2014, followed by a briefing session for industry bodies in the financial services industry on the same day. Over the past 12 months, financial regulators have been in communication with licensed financial institutions in their respective sectors to remind them to assess their relevant FATCA compliance implications for their operation and clientele. In particular, they are reminded to have the procedures and systems in place to protect clients' monies, investments, or other interests in financial instruments from withholding by third parties, avoid aiding clients to engage in tax evasion locally or overseas, and promote the orderliness of market operation. We will continue to raise the awareness of all concerned parties, and work with financial regulators, professional organisations, and industry bodies in the interest of our stakeholders to this end.

11. An announcement will be made after the formal signing of the IGA between Hong Kong and the US later this year¹³, and the text of the IGA will be made publicly available then.

¹³ Article 13 of the Basic Law authorises the Hong Kong Special Administrative Region ("HKSAR") to conduct the relevant external affairs in accordance with the Basic Law. For example, under Article 151 of the Basic Law, the Government of the HKSAR, using the name "Hong Kong, China", may maintain and develop relations and conclude and implement agreements on its own, with foreign states and regions and international organisations, in such matters as economic affairs, trade, finance and monetary affairs, shipping, communications, tourism, culture and sports. Under the Basic Law, the conclusion of international agreements by the Government of the HKSAR per se does not require the prior approval of the Legislative Council, whether under the positive or negative vetting procedures.

Comparison between the HK/US TIEA and the OECD Model TIEA

Articles	OECD Model TIEA	HK/US TIEA
1. Object and Scope of the Agreement	This article defines the scope of the Agreement, which is the provision of assistance through EoI that is foreseeably relevant to the administration and enforcement of the domestic laws of the Contracting Parties concerning taxes covered by the Agreement, and foreseeably relevant to the determination, assessment and collection of such taxes, recovery and enforcement of tax claims, or the investigation or prosecution of tax matters. Information shall be treated as confidential in the manner provided in Article 8.	In general, the HK/US TIEA covers the same object and scope as the OECD model. It is also more or less the same as TIEAs recently signed by the US with other jurisdictions (such as Cayman Islands).
2. Jurisdiction	This Article addresses the jurisdictional scope of the Agreement. A requested party is not obligated to provide information which is neither held by its authorities nor in the possession or control of persons within its territorial jurisdiction.	The HK/US TIEA adopts the OECD model with further elaboration to explain that information to be exchanged is not limited to that relating to the affairs of residents of one or both of the Contracting Parties. This is in line with the EoI article in CDTA.
3. Taxes Covered	This Article intends to identify taxes with respect to which the Contracting Parties agree to exchange information in accordance with the provisions of the Agreement. Its scope is not restricted and a positive listing is not required.	To honour our earlier commitment to LegCo, we have adopted a positive listing approach in setting out the taxes covered by the HK/US TIEA. The tax types covered in the case of the US include – (i) federal taxes on income; (ii) federal taxes related to employment and self-employment;

Articles	OECD Model TIEA	HK/US TIEA
		(iii) federal estate and gift taxes; and (iv) federal excise taxes.
4. Definitions	This Article contains the definitions of terms for purposes of the Agreement.	The HK/US TIEA contains all the definitions in the model, except the ones on “criminal laws” and “criminal tax matters”, because no differential treatment between criminal matters and other matters is required.
5. Exchange of Information Upon Request	This Article provides the general rule that the Competent Authority of the requested party must provide information upon request for the purposes referred to in Article 1, clarifies that a Contracting Party will have to take action to obtain the information requested, and lists out the information the applicant party must provide to the requested party in order to demonstrate the foreseeable relevance of the information requested.	The HK/US TIEA adopts the OECD model. We have added two more items to the list of information that the applicant party should provide to demonstrate the foreseeable relevance of the information requested in view of our Inland Revenue (Disclosure of Information) Rules, i.e. Article 5(c) on period of time with respect to which the information is requested, and Article 5(e) on grounds for believing that the information requested is foreseeably relevant to tax administration or enforcement of the applicant party.
6. Tax Examinations Abroad	This Article provides the arrangement for tax examinations abroad.	No such Article in the HK/US TIEA, because our policy does not allow for tax examinations abroad.
7. Possibility of Declining a Request	This Article identifies the situations in which a requested party is not required to supply information in response to a request.	This becomes Article 6 in the HK/US TIEA. The HK/US TIEA covers all the paragraphs in the OECD model, except paragraph 6 ¹⁴ . The US has

¹⁴ Article 7(6) of the OECD Model TIEA states that “the requested Party may decline a request for information if the information is requested by the applicant Party to administer or enforce a provision of the tax law of the applicant Party, or any requirement connected therewith, which discriminates against a national of the requested Party as compared with a

Articles	OECD Model TIEA	HK/US TIEA
		explained that they do not include such paragraph in their TIEAs, since the tax imposed by the US on branch profits or on the premium income of non-resident insurers may be regarded as discriminatory in the US. The US needs to exclude this paragraph to avoid disputes in this regard. Considering that this paragraph is rarely applied and its deletion will have minimal impact on Hong Kong, we find the current version acceptable.
8. Confidentiality	This Article intends to ensure that adequate protection is afforded to information received from another Contracting Party. Safeguards include: information received shall be treated as confidential, disclosure is only allowed to persons or authorities (including courts and administrative bodies) 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, information shall be used for tax purposes only, and no disclosure to third jurisdiction is allowed.	This becomes Article 7 in the HK/US TIEA. The HK/US TIEA in general adopts the OECD model. Upon the US' request, disclosure to oversight bodies as positively listed out in the Protocol is allowed.
9. Costs	This Article provides that incidence of costs incurred in providing assistance shall be agreed by the Contracting Parties.	This becomes Article 8 in the HK/US TIEA. Given that it is our policy intention to charge the applicant party for extraordinary costs incurred while the requested party will bear the ordinary costs, we have crafted the Article accordingly to

national of the applicant Party in the same circumstances”.

Articles	OECD Model TIEA	HK/US TIEA
		reflect such intention.
10. Implementation Legislation	This Article provides that the Contracting Parties shall enact any legislation necessary to comply with, and give effect to, the terms of the Agreement.	No such Article in the HK/US TIEA for simplicity sake.
11. Language	This Article provides the Competent Authorities of the Contracting Parties with the flexibility to agree on the language that will be used in making and responding to requests. This Article may not be required in a bilateral version.	No such Article in the HK/US TIEA for simplicity sake.
12. Other International Agreements or Arrangements	This Article intends to ensure that the applicant party is able to use the international instrument it deems most appropriate for obtaining necessary information. This Article may not be required in a bilateral version.	No such Article in the HK/US TIEA, because this article is not required in the bilateral context.
13. Mutual Agreement Procedure	This Article provides that Competent Authorities shall endeavor to resolve disputes by mutual agreement where difficulties or doubts arise regarding the implementation or interpretation of the Agreement.	This becomes Article 9 in the HK/US TIEA. The HK/US TIEA in general adopts the OECD model.
14. Depositary's Functions	This Article would be unnecessary in a bilateral version.	No such Article in the HK/US TIEA, because this is not required in the bilateral context.
15. Entry into Force	This Article provides that the Agreement is subject to ratification, acceptance or approval by the Contracting Parties in accordance with their respective laws. Date of entry into force with respect to exchange of	This becomes Article 10 in the HK/US TIEA. Since the US does not need to undergo any ratification or approval procedures for bringing the Agreement into force, the HK/US TIEA only

Articles	OECD Model TIEA	HK/US TIEA
	information for criminal tax matters is earlier than that for all other matters.	mentions that the Agreement shall enter into force on the date of Hong Kong's notification to the US. Also, there is no mention of criminal tax matters as we do not have differential treatment between criminal tax matters and other matters with respect to time limit on disclosure.
16. Termination	This Article provides that termination becomes effective on the first day of the month following the expiration of a period of six months after the date of receipt of notice of termination.	This becomes Article 11 in the HK/US TIEA. We adopt "the date of notice of termination" instead of "date of receipt of notice of termination" upon the US' suggestion, as the time difference should be negligible.