

For discussion on  
3 November 2014

**Legislative Council Panel on Financial Affairs**

**Automatic Exchange of Financial Account Information in Tax Matters**

**Purpose**

This paper briefs Members on the latest international development on tax transparency and the Government's preliminary thinking on how to pursue automatic exchange of financial account information ("AEOI") in tax matters in Hong Kong.

**Hong Kong's Current Policy on Exchange of Tax Information**

2. It has all along been the Government's policy priority to expand our network of comprehensive avoidance of double taxation agreements ("CDTAs") with our major trading and investment partners, with a view to enhancing Hong Kong's competitiveness as an international financial and business centre. At the same time, as a responsible member of the international community, Hong Kong is committed to enhancing tax transparency and preventing tax evasion. Hence, we have incorporated in all 31 CDTAs signed<sup>1</sup> an exchange of information ("EOI") article which is on par with the prevailing international standard as far as practicable.

3. Over the past few years, the international landscape on tax cooperation has been evolving rapidly. In view of the increasing aspirations of the international community, Hong Kong has been making sustained efforts to catch up with the evolving international standards to liberalise our EOI arrangement in the past few years. In 2010, we amended our tax law to remove the domestic tax interest requirement<sup>2</sup> in exchanging information on request. In 2013, we put in place a

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<sup>1</sup> Our 31 CDTA partners include Belgium (2003), Thailand (2005), Mainland China (2006), Luxembourg (2007), Vietnam (2008), Brunei, the Netherlands, Indonesia, Hungary, Kuwait, Austria, the United Kingdom, Ireland, Liechtenstein, France, Japan, New Zealand (2010), Portugal, Spain, the Czech Republic, Switzerland, Malta (2011), Jersey, Malaysia, Mexico, Canada (2012), Italy, Guernsey, Qatar (2013), Korea and South Africa (2014). (*Note: The years in brackets denote the years in which the relevant CDTAs were signed.*)

<sup>2</sup> The concept of domestic tax interest describes a situation where a contracting party can only provide information to another contracting party if it has an interest in the requested information for its own purposes.

legal framework for entering into tax information exchange agreements (“TIEAs”) with other jurisdictions, given the prevailing international standard that a jurisdiction should make available both CDTAs and TIEAs as instruments for EOI.

4. At present, Hong Kong is able to exchange tax information upon request with our treaty partners under either CDTAs or TIEAs. We have adopted highly prudent safeguard measures to protect taxpayers’ privacy and confidentiality of information exchanged, which do not allow automatic or spontaneous EOI, tax examinations abroad, assistance in tax collection, etc.

## **Latest Developments in International Tax Cooperation**

5. Recently, members of the international community have been advocating AEOI as a more efficient mode of international tax cooperation and have made it a new global standard. As early as in September 2013, the G20 committed to adopting AEOI as the new global standard. The G20 has also tasked the Global Forum on Transparency and Exchange of Information for Tax Purposes (“Global Forum”)<sup>3</sup> to establish a mechanism by 2015 to monitor and review the implementation of AEOI in its member jurisdictions.

6. The Organisation for Economic Cooperation and Development (“OECD”) released in July 2014 the Standard for Automatic Exchange of Financial Account Information in Tax Matters, calling on governments of various jurisdictions to obtain detailed financial 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 has also invited all its members, including Hong Kong, to commit to implementing the new global standard. By mid-October 2014, 67 jurisdictions<sup>4</sup> have already publicly committed to the implementation of the new global standard.

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<sup>3</sup> The Global Forum is a widely-represented body consisting of some 120 member jurisdictions including Hong Kong for pursuance of tax transparency agenda.

<sup>4</sup> These jurisdictions so far include Andorra, Anguilla, Argentina, Australia\*, Austria, Belgium, Bermuda, Brazil, British Virgin Islands, Bulgaria, Canada, Cayman Islands, Chile, People’s Republic of China\*, Colombia, Costa Rica, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Faroe Islands, Finland, France\*, Germany\*, Gibraltar, Greece, Guernsey, Hungary, Iceland, India\*, Indonesia, Ireland, Isle of Man, Israel, Italy\*, Japan\*, Jersey, Korea\*, Latvia, Liechtenstein, Lithuania, Luxembourg, Malaysia\*, Malta, Mexico, Montserrat, Netherlands\*, New Zealand, Norway, Poland, Portugal, Romania, Russian Federation, Saudi Arabia, Singapore\*, Slovak Republic, Slovenia, South Africa, Spain, Sweden, Switzerland\*, Turkey, Turks & Caicos Islands, United Kingdom\*, United States\*, and the European Union. Those marked with \* are amongst the top 20 trading partners of Hong Kong.

## Importance to Support the New Global Standard on AEOI

7. Hong Kong has been practicing a simple, territorial-based tax regime. In terms of policy and legal framework, moving towards AEOI represents a quantum jump from our current position of implementing EOI on request. However, as mentioned in paragraph 6 above, a large number of jurisdictions, including 14 jurisdictions amongst Hong Kong's top 20 trading partners, have already indicated support to the implementation of AEOI. In fact, a group of 44 jurisdictions, namely the "Early Adopters Group"<sup>5</sup>, have already publicly committed to pursuing a fast track for commencing the first automatic information exchanges in 2017 (as opposed to the latest timeline of 2018 allowable by the Global Forum). The Early Adopters Group has been urging others to expedite the implementation of AEOI so as to ensure a level-playing field among financial centres.

8. As a responsible and co-operative member of the international community, Hong Kong is duty-bound to offer a clear commitment to the new global standard at the earliest practicable opportunity. We do not under-estimate the workload and challenges ahead to put in place the required legal framework for effecting AEOI. With best endeavours, we seek to complete the necessary consultation and legislative process in time for the first automatic information exchanges to commence by the end of 2018, the latest timeline allowable by the Global Forum.

9. We have indicated to the Global Forum our support for implementing the new global standard on AEOI on a reciprocal basis with appropriate partners which can meet relevant requirements on protection of privacy and confidentiality of information exchanged and ensuring proper use of the data, with a view to commencing the first information exchanges by the end of 2018, **on the condition** that Hong Kong could put in place necessary domestic legislation by 2017. In taking the matter forward domestically, the Government will go through the due process of engaging relevant stakeholders, addressing relevant policy and legal issues involved and seeking the Legislative Council's ("LegCo") approval of the legislation required to implement the new global standard.

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<sup>5</sup> The Early Adopters Group consists of some 40 jurisdictions, including Argentina, Belgium, Bulgaria, Colombia, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, India, Ireland, Italy, Latvia, Liechtenstein, Lithuania, Malta, Mexico, Netherlands, Norway, Poland, Portugal, Romania, Slovak Republic, Slovenia, South Africa, Spain, Sweden, the United Kingdom, and the Faroe Islands; the United Kingdom's Crown Dependencies of Guernsey, Isle of Man and Jersey; and the United Kingdom's Overseas Territories of Anguilla, Bermuda, the British Virgin Islands, the Cayman Islands, Gibraltar, Montserrat, and the Turks & Caicos Islands.

## Key Components of AEOI Standard

10. 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. The information which is exchanged is collected in the source jurisdiction on a routine basis, through the reporting by the financial institutions. In this regard, financial institutions could leverage and build up on their institutional arrangements made for compliance with the United States' Foreign Account Tax Compliance Act ("FATCA") to cater for the reporting requirements for implementing AEOI.

11. "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. The diagram at **Annex** illustrates the differences between how EOI on request and AEOI work.

12. While the AEOI standard has been developed by drawing somewhat extensively on the basis of FATCA, the AEOI standard itself consists of a **fully reciprocal system** from which certain US specificities have been removed, and that terms, concepts and approaches have been standardized 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. Unlike FATCA, reportable persons under the AEOI standard are defined with reference to tax residence rather than citizenship or nationality.

13. The Standard on Automatic Exchange of Financial Account Information in Tax Matters published by the OECD in July 2014 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<sup>6</sup>.

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<sup>6</sup> The AEOI standard contains specific rules on the confidentiality of the information exchanged whereas the underlying international legal exchange instruments already contain safeguards in this regard. The

- (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 account holders’ 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 EOI article under the CDTAs and TIEAs) and the Multilateral Convention on Mutual Administrative Assistance in Tax Matters are legal

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OECD has devised a questionnaire to assist jurisdictions in assessing whether the other jurisdiction has met the required confidentiality and data safeguards. Where these standards are not met (whether in law or in practice) or the treaty partners have breached the confidentiality rules, jurisdictions can suspend the transmission of information to the relevant treaty partners.

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.

## **Key Components Required in Hong Kong's Legal Framework to Implement AEOI**

14. At present, Hong Kong's competent authority (i.e. the Inland Revenue Department ("IRD")) has legal backing and sufficient powers to implement EOI on request under CDTAs or TIEAs. Legislative amendments, however, are required to implement AEOI. Subject to the enactment of the relevant legislation, the new AEOI regime and the existing EOI on request regime will operate in a complementary manner.

15. Our initial thinking is to amend the Inland Revenue Ordinance (Cap. 112) so as to put in place the necessary enabling provisions for AEOI. We are inclined to make use of the bilateral EOI instruments (i.e. CDTA or TIEA) as the legal basis for implementing AEOI at the present stage, meaning that our future AEOI partner must either be our CDTA or TIEA partner. This may serve as an impetus for us to further expand Hong Kong's network of CDTAs/TIEAs whilst allowing us to have more flexibility in identifying our AEOI partners, having regard to their legal framework and practices of protecting taxpayers' privacy and confidentiality of information exchanged.

16. Based on our preliminary research so far, we envisage that the proposed legal framework for Hong Kong to implement AEOI should at least carry the following key components -

- (a) prescribing obligations on financial institutions to undertake **due diligence procedures** to identify reportable accounts and to **furnish annual returns** to the IRD on the financial information in respect of the accounts in the format as prescribed by the Commissioner of Inland Revenue ("CIR");

- (b) introducing **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) providing IRD with **powers of gathering information on reportable accounts from financial institutions** in prescribed format for the purpose of AEOI, while IRD's existing powers to gather information from identified persons for the purpose of EOI on request would remain unchanged;
- (d) including necessary **safeguards** to protect data privacy and confidentiality following international standards; and
- (e) introducing necessary **sanctions** to ensure compliance.

17. Besides, we will review if there would be any interfacing issues with other relevant ordinances. We will also examine the case for allowing some "low-risk" entities or accounts to be exempted from reporting, as well as considering a mechanism for the financial account holders to request for review of financial information to be transmitted.

## **Engagement with Relevant Stakeholders**

18. To take forward the matter of AEOI, we have started engaging relevant stakeholders such as financial industry bodies, business chambers and professional associations with a view to gauging their initial views on how AEOI should be implemented in Hong Kong. Their feedback, particularly those relating to the practicalities of implementation, would be most useful to our formulation of detailed legislative proposals.

19. In general, the stakeholders that we have approached so far support Hong Kong's commitment to implementing the new global standard of AEOI given the latest international trend. At the same time, there are concerns about the actual implementation of AEOI in Hong Kong, such as which financial institutions to report and how to identify reportable persons and accounts. Some of the stakeholders have flagged up the implications on their compliance costs. They also consider that Hong Kong should exercise caution in identifying future AEOI partners, and that safeguards to be adopted for protection of privacy and confidentiality of information exchanged under the AEOI regime should be on par with those currently available under the EOI upon request mechanism as far as practicable.

20. When drawing up specific legislative proposals in the coming year or so, we will have due regard to the stakeholders' views, the international standards and other jurisdictions' approach in taking forward the same matter.

## **Way Forward**

21. According to the Global Forum, following the indication of support for the new global standard on AEOI, all jurisdictions will have to submit initial implementation plans before the Global Forum plenary in October 2015. Subsequently, each jurisdiction will have to provide a written report, on an annual basis, to the Global Forum, indicating the progress made in delivering the implementation plan. The first automatic information exchanges are expected to commence by the end of 2018 the latest.

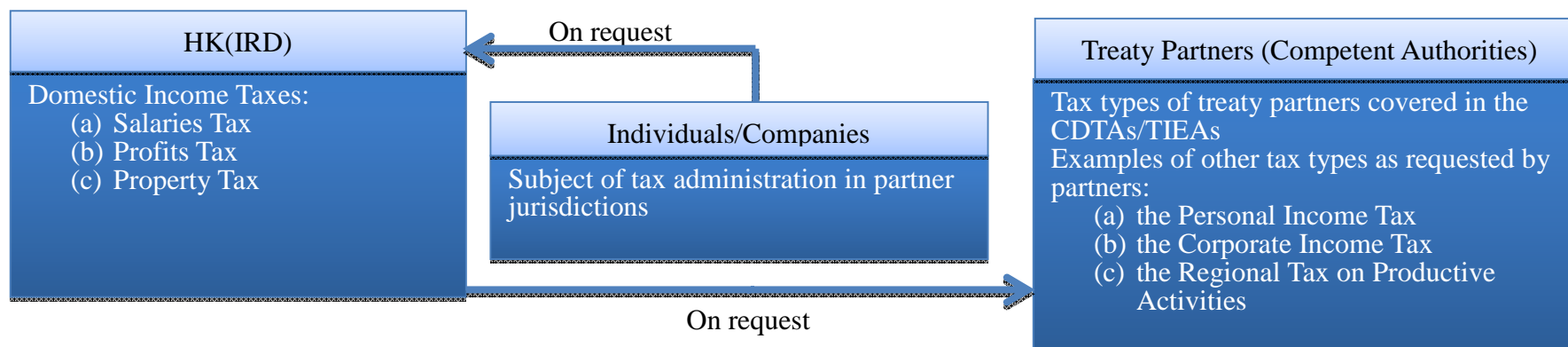
22. On the domestic front, the Government will continue to keep close liaison with relevant stakeholders on the AEOI matter to ensure that their concerns are well addressed when drawing up our legislative proposals. Our current target is to work out the specific legislative proposals in 2015. We will further consult Members and relevant stakeholders before submitting the relevant Bill to the LegCo in 2016.

**Financial Services and the Treasury Bureau**  
**October 2014**



## 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)

