財經事務及庫務局

香港添馬添美道二號
政府總部二十四樓

FINANCIAL SERVICES AND THE TREASURY BUREAU
24/F, Central Government Offices,
2 Tim Mei Avenue, Tamar
Hong Kong

電話號碼 Tel. No. : 2810 2400
傳真號碼 Fax No. : 2179 5848
本函檔號 Our Ref. : TsyB R 183/700-6/7/0(C)
來函檔號 Your Ref. : LS/B/13/15-16

1 February 2016

Ms Clara Tam
Assistant Legal Advisor
Legal Service Division
Legislative Council Secretariat
Legislative Council Complex
1 Legislative Council Road
Central, Hong Kong

Dear Ms Tam,

Inland Revenue (Amendment) Bill 2016

Thank you for your letter of 26 January 2016 on the captioned Bill. The response from the Financial Services and the Treasury Bureau is set out in the attached note.

Yours sincerely,

Crystal Yip

(Miss Crystal Yip)
for Secretary for Financial Services and the Treasury

c.c.
Commissioner of Inland Revenue (Attn.: Mr K K Chiu) (Fax: 2877 1082)
Department of Justice (Attn.: Mr Alan Chong) (Fax: 3918 4613)
(Attn.: Ms Phyllis Poon) (Fax: 3918 4613)

Inland Revenue (Amendment) Bill 2016

Administration's Response

The Inland Revenue (Amendment) Bill seeks to amend the Inland Revenue Ordinance ("IRO") (Cap. 112) to provide a legislative framework for the implementation of automatic exchange of financial account information in tax matters ("AEOI") in Hong Kong, with a view to complying with the latest international standard for AEOI (as set out in the CRS arrangements) promulgated by the Organisation for Economic Cooperation and Development ("OECD").

Policy objectives

2. Being an international financial centre and a responsible member of the international community, Hong Kong has been committed to enhancing tax transparency and combatting cross-border tax evasion. In September 2014, Hong Kong indicated to the Global Forum on Transparency and Exchange of Information for Tax Purposes of the OECD our commitment that, subject to the passage of local legislation, AEOI would be implemented on a reciprocal basis with appropriate partners which could meet relevant standards on protection of privacy and confidentiality of information exchanged and ensuring proper use of the data exchanged, with a view to commencing the first information exchanges by the end of 2018 (i.e. the latest timeline permissible by the OECD).

3. We will adopt a **pragmatic approach** to include all essential requirements of the AEOI standard in our domestic law, so as to ensure effective implementation of the international standard while not creating undue burden of compliance on financial institutions ("FIs"). Moreover, while the Common Reporting Standard ("CRS") provides a multilateral agreement for implementing AEOI and a considerable number of jurisdictions choose to adopt the multilateral model, CRS also allows implementing AEOI on a bilateral basis. In this light, we intend to conduct AEOI only with our partners with which we have signed comprehensive avoidance of double taxation agreement ("CDTA") or tax information exchange agreement ("TIEA") on a **bilateral** basis. Under

such an approach, Hong Kong will rely on the CDTAs or TIEAs signed and having effect by way of Orders made under section 49(1A) of the IRO as the basis for implementing AEOI. IRD would still have to sign a new Competent Authority Agreement ("CAA") with the treaty partners concerned. This approach will not only help us achieve the policy objective of continuing to expand Hong Kong's CDTA network, but will also enable us to implement AEOI in a pragmatic and orderly manner. Further, this approach will ensure that the safeguards provided under the CDTAs and TIEAs for protecting taxpayers' privacy and confidentiality of information exchanged will be applicable to the AEOI arrangement.

Structure of the Bill

4. Despite the length of the Bill, the structure of the Bill is not complicated, which comprises mainly six parts –

(a) The first part is **interpretation (i.e. new section 50A added by Clause 4 of the Bill)**, which provides for the definitions of various key terms and phrases for the implementation of AEOI. Generally speaking, we have followed the definitions for all key terms and phrases provided in CRS promulgated by OECD. However, in view of the need for domestic implementation of the law, we have included references to our domestic law and made adaptation to certain definitions where appropriate. For instance, for the definition of depository institution, we have included reference to the Banking Ordinance (Cap. 155), and we have defined what is meant by FIs "resident in Hong Kong" in the definition of "reporting FI". Moreover, for clarity sake, having made reference to the relevant provisions of the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615), and the latest standard concerned regarding the definition of "controlling person", we have specified what is meant by exercising control over an entity under different circumstances (i.e. as a corporation, partnership or trust; and not a corporation, partnership or trust).

(b) The second part is about **reporting FIs' due diligence obligations (i.e. new section 50B added by Clause 4 of the Bill)**. This part

provides that a reporting FI must establish, maintain and apply the due diligence procedures so as to identify "reportable accounts", in particular incorporating the requirements provided in CRS as set out in the new Schedule 17D into the relevant procedures. Under CRS, jurisdictions may require reporting FIs that they must identify accounts held by all non-local tax residents of any other jurisdictions (i.e. "wider approach") and collect and report the required information. However, we only opt for mandatory implementation of a "targeted approach". In other words, FIs are only required to establish, maintain and apply procedures to identify and collect information of accounts held by tax residents of the reportable jurisdictions (i.e. reportable accounts). That notwithstanding, during actual operation, it would be a usual practice for reporting FIs to collect information (including tax identification numbers ("TINs"), etc.) of the tax residents holding the financial accounts (no matter whether they belong to any reportable jurisdictions), so as to identify and verify if the relevant account is a reportable account. Having regard to the views expressed by most FIs during the consultation period, we propose to provide for a clear legal basis in the Bill so as to provide that reporting FIs may apply the same procedures to identify accounts held by tax residents of any other jurisdictions outside Hong Kong and collect the required information (i.e. "wider approach").

(c) The third part is about **reporting FIs' obligations to file returns and the scope of required information to be furnished to IRD (i.e. new sections 50C, 50D, 50F and 50G added by Clause 4 of the Bill)**. Reporting FIs are required to file returns in accordance with the notice issued by IRD and the relevant requirements. Regarding the information that a reporting FI has to furnish to IRD (including personal and financial account information), we have followed the requirements set out in CRS.

(d) The fourth part is about the **enforcement powers of IRD and the penalties imposed for non-compliance (i.e. new sections 51BA and 80B to 80F added by Clauses 7 and 10 of the Bill respectively, and sections 51B and 80 amended by Clauses 6 and 9 of the Bill respectively)**. In order to ensure that Hong

Kong will effectively implement AEOI as set out in CRS, the Bill provides IRD with certain basic enforcement powers, including the powers to require reporting FIs to furnish information about reportable accounts in the specified format, have access to the business premises of a reporting FI to inspect its compliance system and process, and require a reporting FI to rectify its system or process for any non-compliance. Furthermore, the Bill also proposes various penalty provisions for reporting FIs, employees engaged by relevant FIs, service providers and account holders. We have made reference to similar penalty provisions in the existing IRO, so as to ensure that the proposed penalties are proportional and will achieve effective deterrent effect.

(e) The fifth part is about **"non-reporting FIs"** and **"excluded accounts" (i.e. new Schedule 17C added by Clause 11 of the Bill)**. CRS provides that certain FIs and accounts, which present a low risk of being used for tax evasion, can be exempted from reporting. The lists set out in the relevant Schedule are formulated in accordance with the items specified in CRS. Furthermore, CRS allows jurisdictions to identify additional items for exemptions, subject to certain stringent criteria. These criteria are –

(i) whether or not it presents a low risk of being used for tax evasion;
(ii) whether it bears substantially similar characteristics to any "non-reporting FIs" or "excluded accounts" under CRS; and
(iii) whether it is subject to regulation or some form of information reporting to the tax authority.

In accordance with these criteria and having regard to the views collected during the consultation period, we propose that apart from providing for the "non-reporting FIs" and "excluded accounts" set out in CRS in the Bill, the Hong Kong Monetary Authority and its pension fund, the Grant Schools Provident Fund and Subsidised Schools Provident Fund, as well as the Mandatory Provident Fund Schemes, the Occupational Retirement Schemes and the Credit Unions registered under the relevant ordinances will be

incorporated into "non-reporting FIs", and dormant accounts into "excluded accounts".

(f) The sixth part is about **due diligence requirements (i.e. new Schedule 17D in the Bill)**. This part has strictly followed the details of the due diligence procedures required to be carried by reporting FIs in CRS (including the due diligence procedures for pre-existing/new accounts, individual/entity accounts, low value/high value accounts). We have included dates in the relevant provisions for actual operation.

Comparison between the Bill and CRS

5. Generally speaking, as mentioned in paragraph 4 above, the major provisions of the Bill have in general followed CRS. The comparison of the major provisions of the Bill and CRS is set out in **Annex**.

Safeguards for protecting taxpayers' privacy and confidentiality of information exchanged

6. The Government has all along attached great importance to the protection of the privacy of taxpayers and the confidentiality of information exchanged, in the course of automatic exchange of financial account information. The EOI article of CDTA and relevant articles of the TIEA provide for safeguards to protect taxpayers' privacy and confidentiality of information exchanged. The relevant CDTAs and TIEAs are implemented by way of Orders made under section 49(1A) of the IRO. Given that we would implement AEOI under the existing CDTA and TIEA framework, the relevant **safeguards will continue to be applicable**. Taking the CDTA signed between Hong Kong and South Africa which has been implemented recently (i.e. Inland Revenue ((Double Taxation Relief and Prevention of Fiscal Evasion with respect to Taxes on Income) (Republic of South Africa) Order (Cap. 122CM)) as an example, Article 24 of that agreement has provided for the relevant safeguards, including –

(a) The information exchanged should be foreseeably relevant, i.e.

there will be no fishing expeditions;

(b) Information received by our partners should be treated as confidential;

(c) Information will only be disclosed to the tax authorities concerned with the assessment or collection of, the enforcement or prosecution in respect of the taxes mentioned in the agreement, and not for release to their oversight bodies unless there are legitimate reasons given by CDTA/TIEA partners;

(d) Information exchanged should not be disclosed to a third jurisdiction;

(e) There is no obligation to supply information under certain circumstances, for example, where the information would disclose any trade, business, industrial, commercial or professional secret or trade process, or which would be covered by legal professional privilege, etc.; and

(f) We would not accede to any requests from our treaty partners for tax examinations abroad (i.e. we have not included such an article in our CDTA/TIEAs)

7. Furthermore, the AEOI standard also provides for similar safeguards. The Model CAA provides that all information exchanged is subject to the confidentiality rules and other safeguards provided for in the Convention/Instrument. It also provides that a competent authority may suspend EOI by giving notice in writing to the other competent authority if there is or has been significant non-compliance by the other competent authority with CAA. The competent authority may also terminate CAA by giving notice of termination to the other competent authority. Termination may take immediate effect pending completion of negative vetting by LegCo of the subsidiary legislation that removes the jurisdiction from the Schedule to IRO. Hence, under the AEOI arrangement, taxpayers' privacy and the confidentiality of information exchanged will be protected.

8. At present, the Inland Revenue (Disclosure of Information) Rules ("Disclosure Rules") (Cap. 112BI) have provided for a notification and review system in handling EOI requests and related appeals. The Disclosure Rules are not applicable to the AEOI arrangement, because according to the existing relevant legislation to protect privacy, account holders can request access to and request correction of their personal data, so as to ensure the information is accurate. In fact, having regard to these concerns, we have communicated with FI groups and reminded them to take appropriate measures as follows –

(a) to amend Personal Information Collection Statement to ensure that customers are duly informed of the purpose of the use of the personal data for AEOI arrangement and the relevant authorities/persons that the information may be transferred to;

(b) to duly inform their account holders in advance, as a matter of good corporate governance, that FIs will collect information such as TINs or dates of birth when the relevant accounts are identified as reportable accounts; and

(c) to take all practicable steps to ensure that the personal data is accurate, and account holders will be allowed to review and correct their personal and financial data.

Moreover, having made reference to the legal frameworks for AEOI implementation in other jurisdictions, we are not aware of any similar notification and review system by the competent authorities of other jurisdictions for AEOI. We have also taken into account the requirements of AEOI and the actual operation. If a notification and review mechanism is in place, it would unduly delay effective EOI, which is against the EOI principles of OECD.

Financial Services and the Treasury Bureau
February 2016

Annex

Comparison between the major provisions of the Bill and CRS

Proposed provisions in the Bill	Relevant provisions in CRS	Comparison
1. New section 50A added by Clause 4 of the Bill – Interpretation	Section VIII of CRS (except B(5)-(9) and C(17))	We have in general followed the definitions of all key terms and phrases in CRS promulgated by OECD. However, in view of the need for domestic law implementation, we have included references to our domestic law and made adaptations to the definitions where appropriate. The major definitions that we have made adaptations are as follows – (a) **"Depository institution"**, "**investment entity"** and "**specified insurance company**": We have included references to the Banking Ordinance (Cap. 155), the Securities and Futures Ordinance (Cap. 571) and the Insurance Companies Ordinance (Cap. 41) respectively, so as to provide clarity to the definitions. (b) "**Reportable FI"**: CRS provides a general definition for "reporting FI". In order to effectively implement AEOI, we have to clearly define which FIs are reporting FIs in Hong Kong. Hence, we have made adaptation to the definition so as to clearly elucidate the definition of FIs "resident in Hong Kong". (c) "**Reportable jurisdiction"**: The definition in the Bill in general follows that in CRS. Since our policy objective is to implement AEOI only with

Proposed provisions in the Bill	Relevant provisions in CRS	Comparison
		partners which have signed CDTAs or TIEAs with Hong Kong, we have provided, for clarity sake, that "reportable jurisdiction" must be a party to an arrangement having effect under section 49(1A) of IRO and requiring disclosure of information concerning tax of the territory. (d) "**Participating jurisdiction**": Since "participating jurisdiction" is the one which provides information to Hong Kong (while "reportable jurisdiction" is the one to which Hong Kong provides information), we consider it appropriate to simplify the relevant definition. (e) "**Jurisdiction of residence"** and "**resident for tax purposes**": While CRS does not specifically provide definitions on "jurisdiction of residence" and "resident for tax purposes", we have provided, for clarity sake, explanation to these two terms, which is in line with the interpretation in CRS. (f) **"Controlling person"**: We have in general followed the definition in CRS. For clarity sake, we have clearly provided in the Bill what is meant by exercising control over an entity under different circumstances (i.e. as a corporation, partnership or trust; and not a corporation, partnership or trust). Since CRS stipulates that the term "controlling person" corresponds to the term "beneficial owner" as described in the Financial Action Task Force ("FATF") Recommendations, when formulating the relevant provisions, we have made reference to the pertinent provisions in the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615), and adopted the latest threshold of

Proposed provisions in the Bill	Relevant provisions in CRS	Comparison
		verifying the beneficial owner under the FATF Recommendations (i.e. 25%). (g) **"Calendar year**": CRS does not have such definition. For clarity sake, a definition is included in the Bill. (h) **"Reporting year**": CRS does not have such definition. To enable reporting FIs to start collecting financial account information for a certain reportable jurisdiction, we have introduced the concept and included a definition of "reporting year".
2. New section 50B added by Clause 4 of the Bill – Reporting FIs' due diligence obligations	Sections II to VII of CRS sets out the details of the due diligence procedures	We have added section 50B to provide that reporting FIs have to conduct due diligence. Other jurisdictions (such as the UK and Ireland) have similar provisions. We have incorporated the due diligence procedures set out in Sections II to VII of CRS into the new Schedule 17D. Moreover, we have also included relevant provisions to provide legal basis for the "wider approach".
3. New sections 50C, 50D, 50F and 50G added by Clause 4 of the Bill – Reporting FIs'	Section I of CRS sets out the details of information to be furnished by reporting FIs	We have added section 50C to provide for the logistics arrangement for reporting FIs to file returns. Other jurisdictions (such as the UK and Ireland) have similar provisions. Moreover, in order to facilitate smooth implementation of AEOI, we have

Proposed provisions in the Bill	Relevant provisions in CRS	Comparison
obligation to file returns and the required information		added section 50D to require reporting FIs to notify IRD of opening/maintain reportable accounts and changing address. As for new sections 50F and 50G added by Clause 4 of the Bill, they follow the information required to be furnished by reporting FIs as set out in Section I of CRS, as well as the exemption arrangements (such as under what circumstances information on place of birth is not required).
4. New section 50H added by Clause 4 of the Bill – engagement of service providers	Section II(D) of CRS	We have in general followed the arrangement in CRS.
5. Section 51B amended by Clause 6 of the Bill and new section 51BA added by Clause 7 of the Bill – IRD's enforcement	Section 9 of CRS provides that a jurisdiction must have rules and procedures to ensure effective implementation of AEOI, including verifying FIs'	CRS only provides for the general principle. In order to effectively implement AEOI, we have to provide IRD with basic enforcement powers.

Proposed provisions in the Bill	Relevant provisions in CRS	Comparison
powers	compliance with the due diligence and reporting requirements.	
6. Section 80 amended by Clause 9 of the Bill and sections 80B to 80F added by Clause 10 of the Bill – penalties	Section IX of CRS provides that a jurisdiction must have rules and procedures to ensure effective implementation of AEOI.	CRS only provides for the general principle. In order to achieve certain deterrent effect, we have to provide for appropriate penalty provisions for non-compliance concerning reporting FIs, employees of relevant FIs, service providers and account holders.
7. New Schedule 17C added by Clause 11 of the Bill – Non-reporting FIs and excluded accounts	Sections XIII(B) and XIII(C)(17) of CRS provide for the non-reporting FIs and excluded accounts, which also allow jurisdictions to identify additional items for exemptions,	Apart from the non-reporting FIs and excluded accounts stipulated in CRS, we have also abide by the CRS criteria and added the following non-reporting FIs and excluded accounts – <u>Non-reporting FIs</u> (a) Hong Kong Monetary Authority and its pension fund (b) Grant Schools Provident Fund and Subsidized Schools Provident Fund (c) Mandatory Provident Fund Schemes registered under the Mandatory Provident Fund Schemes Ordinance (Cap. 485); and Occupational

Proposed provisions in the Bill	Relevant provisions in CRS	Comparison
	subject to certain stringent conditions.	Retirement Schemes registered under the Occupational Retirement Schemes Ordinance (Cap. 426), including polling agreement and approved pooled investment funds with participants confined to the above schemes (d) Credit Unions registered under the Credit Unions Ordinance (Cap. 119) <u>Excluded accounts</u> (a) Dormant accounts Furthermore, regarding the "exempt collective investment vehicle", if it has issued physical shares in bearer form but meets certain requirements (such as the investment entity does not issue any physical shares in bearer form after a certain date), it will be exempted. However, CRS has not stipulated the relevant date. For the sake of effective implementation, we have set out the relevant date. Since the Bill is for implementation in Hong Kong, we have translated the unit in US dollar in CRS into Hong Kong dollar.
8. New Schedule 17D added by Clause 11 of the Bill – Due diligence	Sections 2 to 7 of CRS	The Bill has in general followed the due diligence procedures set out in CRS. Having regard to the need of domestic legislation or the long sentence structure in the original text, we have made certain textual amendments and format changes, whilst keeping the meaning of the relevant CRS provisions

Proposed provisions in the Bill	Relevant provisions in CRS	Comparison
requirements		unchanged. Since CRS is applicable to all jurisdictions, it has not stipulated the exact operation dates for relevant provisions. In this regard, we have set out the relevant dates, including – (a) **Low value account (Clause 1 of Part I)**: "…with an aggregate balance or value that does not exceed $7,800,000 as at 31 December of the second year before the reporting year"; (b) **High value account (Clause 1 of Part I)**: "…with an aggregate balance or value that exceeds $7,800,000 as at 31 December of the second year before the reporting year or 31 December of any subsequent year"; (c) **New account (Clause 1 of Part I)**: "…a financial account opened and maintained by a reporting financial institution on or after 1 January 2017"; (d) **Enhanced review procedures for high value accounts (Clause 4(8) of Part 3)**: "If a pre-existing individual account is not a high value account as at 31 December of the second year before the reporting year…"; (e) **Review of pre-existing individual accounts (Clause 5(1) and (2) of Part 3)**: "Review of a pre-existing individual account that is a high value account must be completed on or before 31 December of the year before the reporting year for the account" and "Review of a pre-existing individual account that is low value account must be completed on or before 31 December of the reporting year for the account";

Proposed provisions in the Bill	Relevant provisions in CRS	Comparison
		(f) **Entity accounts not required to be reviewed, identified or reported (Clause 2(1) of Part 5)**: "A pre-existing entity account with an aggregate account balance or value that does not exceed $1,950,000 as at 31 December of the second year before the reporting year... until the aggregate account balance or value exceeds $1,950,000 as at the last day of any subsequent calendar year"; (g) **Entity accounts subject to review (Clause 3 of Part 5)**: "… as at 31 December of the second year before the reporting year…"; (h) **Timing of review (Clause 10(1) of Part 5)**: "Review of a pre-existing entity account with an aggregate account balance or value that exceeds $1,950,000 as at 31 December of the second year before a reporting year must be completed on or before 31 December of the reporting year for the account"; and (i) **Timing of review (Clause 10(2) of Part 5)**: "Review of a pre-existing entity account with an aggregate account balance or value that does not exceed $1,950,000 as at 31 December of the second year before the reporting year, but exceeds $1,950,000 as at the last day of a subsequent calendar year, must be completed within the calendar year following the year in which the aggregate account balance or value exceeds $1,950,000". Since the Bill is for implementation in Hong Kong, we have translated the unit in US dollar in CRS into Hong Kong dollar.

Proposed provisions in the Bill	Relevant provisions in CRS	Comparison
9. New section 61C added by Clause 8 of the Bill	Section IX of CRS provides that a jurisdiction must have rules and procedures to ensure effective implementation of AEOI, including preventing any persons or FIs adopting any practices to avoid obligations	We have in general followed the principle in CRS in drawing up the relevant provision.
10. Other provisions (new sections 50E, 50I, 50J and 50K added by Clause 4 of the Bill)	CRS does not have relevant provisions	The relevant provisions are about the actual implementation of AEOI in the domestic context (such as under new section 50J added by Clause 4 of the Bill, the Secretary for Financial Services and the Treasury may by notice published in the Gazette, amend the Schedules), and hence, CRS does not have these provisions.