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**Paper for the House Committee Meeting
on 22 January 2016**

**Legal Service Division Report on
Inland Revenue (Amendment) Bill 2016**

I. SUMMARY

- 1. The Bill**

The Bill seeks to amend the Inland Revenue Ordinance (Cap. 112) to impose -

 - (a) obligations on certain financial institutions to establish, maintain and apply due diligence procedures for identifying accounts they need to report on and to furnish a return to the Commissioner of Inland Revenue in respect of these accounts; and
 - (b) penalties for non-compliance with the obligations.
- 2. Public Consultation**

According to the Administration, relevant stakeholders including business chambers and professional bodies were consulted in 2015 and the stakeholders supported the implementation of automatic exchange of financial account information in tax matters (AEOI) in Hong Kong.
- 3. Consultation with LegCo Panel**

At the meetings on 3 November 2014 and 6 July 2015, the Panel on Financial Affairs (the Panel) was consulted on the legislative proposals to implement AEOI in Hong Kong. Members raised a number of concerns on the proposals.
- 4. Conclusion**

In the light of the concerns raised at the Panel meetings and the implications of the Bill on the privacy of taxpayers and confidentiality of the tax information exchanged, Members may wish to set up a Bills Committee to study the Bill in detail.

II. REPORT

The date of First Reading of the Bill is 20 January 2016. Members may refer to the LegCo Brief (File Ref.: TsyB R 183/700-6/7/0 (C)) issued by the Financial Services and the Treasury Bureau on 7 January 2016 for further details.

Object of the Bill

2. The Bill seeks to amend the Inland Revenue Ordinance (Cap. 112) to impose -
 - (a) obligations on certain financial institutions to establish, maintain and apply due diligence procedures for identifying accounts they need to report on and to furnish a return to the Commissioner of Inland Revenue in respect of these accounts; and
 - (b) penalties for non-compliance with the obligations.

Background

3. The current legal framework for exchange of information (EOI) is provided for under Part 8 (Double Taxation Relief and Exchange of Information) of Cap. 112 and the orders made under section 49(1A) of Cap. 112¹. The Inland Revenue (Disclosure of Information) Rules (Cap. 112BI) sets out a set of procedures for protection of confidentiality and privacy rights regarding EOI requests.

4. Hong Kong has been implementing EOI with territories outside Hong Kong on request, i.e. information will be only exchanged upon specific requests from the competent authority of a treaty partner under either comprehensive agreements for avoidance of double taxation (CDTAs) or tax information exchange agreements (TIEAs).

5. According to paragraphs 2 and 24 of the LegCo Brief, the Organisation for Economic Co-operation and Development released the new standard on automatic exchange of financial information in tax matters (AEOI) in July 2014, 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. To catch up with the latest EOI standard, the Government has indicated to the Global Forum on Transparency and Exchange of Information for

¹ The Chief Executive in Council may by order declare that arrangements have been made with government of any territory outside Hong Kong, with a view to affording relief from double taxation and/or exchanging information in relation to any tax imposed by the laws of Hong Kong or the territory concerned.

Tax Purposes in September 2014 its support for implementing the new standard on EOI and undertook that AEOI would be implemented on a reciprocal basis with appropriate partners by the end of 2018 on the condition that Hong Kong could put in place necessary domestic legislation by 2017.

Provisions of the Bill

6. To enable the implementation of AEOI in Hong Kong, the Bill seeks to specify certain financial institutions that are required to report (reporting financial institution); the accounts they need to report on (reportable account); the due diligence procedures to identify reportable accounts (due diligence obligations); and the information to be reported (reporting obligations). The Bill also includes enforcement provisions for non-compliance with the obligations imposed. Major provisions are provided in new Part 8A (new sections 50A to 50K) and three new schedules (Schedules 17C, 17D and 17E) proposed to be added to Cap. 112.

Reporting financial institution and reportable account

7. Under the Bill, "reporting financial institution" which is defined to include custodial institutions, depository institutions, insurance companies and investment entities that are resident in Hong Kong are subject to the new reporting obligations. "Reportable account" is defined to mean a financial account identified as such under the required due diligence procedures and that is held by at least one reportable person or a passive entity that is not a financial institution with at least one controlling person being a reportable person (new section 50A(1)). A "reportable person" is defined to mean, among others, an individual or entity that is a resident for tax purposes of a reportable jurisdiction.

8. Certain financial institutions (e.g. governmental entity and central bank) and accounts (e.g. retirement and pension accounts) which present a low risk of being used for tax evasion are exempted. They are listed as "non-reporting financial institutions" and "excluded accounts" respectively in new Schedule 17C.

Reportable jurisdiction

9. Reportable jurisdiction refers to a territory outside Hong Kong that is a party to an arrangement having effect under section 49(1A) of Cap. 112 and requiring disclosure of information concerning tax of the territory (new section 50A(1)), i.e. jurisdictions with which Hong Kong has entered into either CDTA or TIEA. The new Schedule 17E seeks to set out a list of reportable jurisdictions. The Secretary for Financial Services and the Treasury may, by notice published in the Gazette, amend the Schedule.

Due diligence obligations

10. A reporting financial institution must establish, maintain and apply due diligence procedures so as to, among others, identify the jurisdiction of residence of the account holder of a financial account maintained with the institution and to determine whether any account maintained by the institution is an reportable account (new section 50B). The due diligence procedures must also enable the institution to identify and collect the information required to be reported to the Commissioner of Inland Revenue (the Commissioner). Under the Bill, a reporting financial institution is also required to incorporate into those procedures the due diligence requirements set out in new Schedule 17D.

Reporting obligations

11. Under the Bill, a reporting financial institution is required to furnish a return to the Commissioner in relation to reportable accounts with respect to any reportable jurisdictions that are maintained by the reporting financial institution (new section 50C).

12. The new section 50F sets out the required information a return must include in relation to each reportable account. Examples of the required information are as follows -

- (a) name, address, jurisdiction(s) of residence, taxpayer identification number(s) and date and place of birth of each reportable person whether the account holder is an individual or an entity with one or more controlling persons that is a reportable person;
- (b) account number, the account balance or value as of the end of the relevant calendar year or other appropriate reporting period; and
- (c) name and identifying number of the reporting financial institution.

13. Reporting financial institutions are required to furnish the return within the time in such manner and in the form of an electronic record as specified in the notice issued by an assessor and a nil return is required if the financial institution maintains no reportable accounts within the specified period (new section 50C). Further, sufficient records to enable the correctness and accuracy of the return furnished to be readily ascertained must be kept by the reporting financial institution for six years from the date on which the return is furnished (new section 50D). A reporting financial institution may engage a service provider to carry out the obligations under new sections 50B and 50C but the reporting financial institution is not relieved from carrying out such obligations (new section 50H).

Enforcement powers and sanctions

14. The Bill proposes to confer on the Commissioner the following enforcement powers -

- (a) power to obtain a search warrant from a magistrate to be executed against a reporting financial institution where there is non-compliance or suspected non-compliance with the due diligence or return filing requirements (new section 51B(1AAA)); and
- (b) power to enter and inspect the business premises of a financial institution or a service provider and require the financial institution or service provider to rectify its compliance system and process (new section 51BA).

15. The Bill also proposes offences against financial institutions, their employees, service providers, directors or other officers concerned in the management of a corporation in respect of non-compliance with the due diligence and reporting obligations. The maximum penalties for the proposed offences range from a fine at level 3 (\$10,000) and imprisonment for six months on summary conviction to a fine at level 5 (\$50,000) and imprisonment for three years on conviction on indictment (new sections 80B to 80F).

Commencement

16. The Bill, if passed, would come into operation on the day it is published in the Gazette as an Ordinance.

Public Consultation

17. According to paragraph 21 of the LegCo Brief, relevant stakeholders such as financial industry bodies, business chambers and professional bodies were consulted in 2015 on how the Government should adapt to Hong Kong the new standard on EOI. In general, stakeholders supported the overall direction to catch up with the latest international standard and the implementation of AEOI in Hong Kong. The Administration had taken into account the stakeholders' feedback when refining the legislative proposals to the extent allowed under the relevant international standard.

Consultation with LegCo Panel

18. The Panel on Financial Affairs (the Panel) was consulted on the legislative proposals to implement AEOI in Hong Kong at the meetings on 3 November 2014 and 6 July 2015. Members raised enquiries/concerns on a

number of issues, including the benefits for Hong Kong in implementing the AEOI regime, the cost burden on and exemption for financial institutions in complying with the requirements under the proposed regime, safeguards for protecting privacy and confidentiality of information exchanged with AEOI partners, resources implications on the Government in implementing the proposed regime, and the tight legislative timetable for enactment of the Bill.

Conclusion

19. The Legal Service Division is scrutinizing the legal and drafting aspects of the Bill. In view of the concerns raised at the Panel meetings and the implications of the Bill on the privacy of taxpayers and confidentiality of the tax information exchanged, Members may wish to set up a Bills Committee to study the Bill in detail.

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