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Report of the Bills Committee on Inland Revenue (Amendment) Bill 2016

Purpose

This paper reports on the deliberations of the Bills Committee on Inland Revenue (Amendment) Bill 2016 ("the Bills Committee").

Background

Hong Kong's existing policy on exchange of information

2. It has been Government's priority to conclude comprehensive avoidance of double taxation agreements ("CDTAs") with Hong Kong's trading partners to minimize the incidence of double taxation. All CDTAs signed embody a mechanism for exchange of information ("EOI") with treaty partners to enhance tax transparency and combat cross-border tax evasion. In addition, the Government has signed tax information exchange agreements ("TIEAs") purely as instruments for EOI, which do not offer taxation relief. While the international standard for EOI as promulgated by the Organisation for Economic Co-operation and Development ("OECD") permits EOI upon request or on automatic or spontaneous basis, Hong Kong has so far only opted for EOI upon request.

Automatic exchange of financial account information in tax matters

3. OECD released in July 2014 the standard on automatic exchange of financial account information in tax matters ("AEOI"), calling on governments to collect from their financial institutions ("FIs") financial account information of overseas tax residents and exchange the information with jurisdictions of residence of the relevant account holders on an annual basis. Hong Kong

indicated to the Global Forum on Transparency and Exchange of Information for Tax Purposes ("Global Forum") in September 2014 its support for implementing AEOI.

4. The AEOI standard comprises (a) Model Competent Authority Agreement ("Model CAA"), (b) Common Reporting Standard ("CRS"), (c) Commentaries on the Model CAA and CRS, and (d) Guidance on Technical Solutions. In very brief terms, under the AEOI standard, an FI is required to conduct due diligence procedures, so as to identify reportable accounts held by tax residents of reportable jurisdictions (i.e. tax residents who are liable to tax by reason of residence in the AEOI partner jurisdictions), and collect the required information in respect of these reportable accounts. FIs are also required to report such information to the tax authority in specified format. Upon receipt of the information from FIs, the tax authority will exchange the relevant information with their counterparts in the reportable jurisdictions concerned on an annual basis.

The Inland Revenue (Amendment) Bill 2016

5. To provide a legislative framework for the implementation of AEOI, the Inland Revenue (Amendment) Bill 2016 ("the Bill") was published in the Gazette on 8 January 2016 and received its First Reading at the Legislative Council ("LegCo") meeting of 20 January 2016. The Bill amends the Inland Revenue Ordinance (Cap. 112) ("IRO") to enable Hong Kong to comply with the AEOI standard.[1]

The Bills Committee

6. At the House Committee meeting on 22 January 2016, Members agreed to form a Bills Committee to study the Bill. The membership list of the Bills Committee is in **Appendix I**. Under the chairmanship of Mr Andrew LEUNG, the Bills Committee has held six meetings to discuss with the Administration, including one meeting to receive views from deputations. A list of the organizations which have provided views to the Bills Committee is in **Appendix II**.

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[1] All the provisions/schedules mentioned in the ensuing paragraphs of this report refer to those of IRO, unless otherwise stated.

Deliberations of the Bills Committee

7. The main subjects deliberated by the Bills Committee are set out below:

(a) policy approach and justifications for implementing AEOI (paragraphs 8 − 12);

(b) scope of AEOI (paragraphs 13 – 16);

(c) obligations of reporting financial institutions (paragraphs 17 – 30);

(d) enforcement of the AEOI regime (paragraphs 31 – 35);

(e) sanctions (paragraphs 36 – 52); and

(f) safeguarding taxpayers' rights and confidentiality of information exchanged (paragraphs 53 − 57).

Policy approach and justifications for implementing automatic exchange of financial account information in tax matters

8. The Administration intends to conduct AEOI only with partners with which Hong Kong has signed CDTA or TIEA on a bilateral basis. Under such an approach, Hong Kong will rely on the bilateral CDTAs or TIEAs signed and having effect by way of orders made under section 49(1A) as the basis for implementing AEOI. The Inland Revenue Department ("IRD") will still have to sign a new CAA, which sets out the modalities of transfer of information collected pursuant to the AEOI standard, with the tax authority of the CDTA/TIEA partners concerned. The Administration adopts a pragmatic approach to include all essential requirements of the AEOI standard, namely the key provisions of CAA and due diligence requirements laid down in CRS, in the domestic law by amending IRO, so as to ensure effective implementation of the international standard while not creating undue burden of compliance on FIs. This approach will also ensure that safeguards provided under CDTAs and TIEAs for protecting taxpayers' privacy and confidentiality of information exchanged will be applicable to the AEOI arrangement.

9. The Bills Committee notes that not all members of the Global Forum of OECD have indicated commitment to implementing AEOI, and the United States ("US") (which is an OECD member) is a case in point.[2] Mr SIN Chung-kai has enquired whether it is absolutely necessary for Hong

[2] According to the Administration, US did not sign up to implement AEOI because its Financial Account Tax Compliance Act has served a similar purpose to require foreign FIs (including those in Hong Kong) to report financial account information in respect of their US clients to the US Internal Revenue Service directly.

Kong to implement AEOI as Hong Kong has all along been practising a territorial-based tax regime, and the adverse impact on Hong Kong if it does not pursue this new standard. Mr Jeffrey LAM, on the other hand, has raised concerns as to whether implementation of AEOI will suffice to meet the latest standard of EOI and to demonstrate Hong Kong's commitment to enhancing tax transparency.

10. The Administration has advised that the international standard on EOI (including AEOI) was promulgated by OECD while the Global Forum monitors and reviews the progress of implementation. Hong Kong as one of the Global Forum members was invited to commit to implementing AEOI. Out of the 100 members of the Global Forum, 97 jurisdictions, which include the United Kingdom ("UK"), France, Australia, Japan and Singapore, etc., have already expressed such commitment. It is also notable that among the 20 top trading partners of Hong Kong, more than half of them have indicated support for AEOI. In view of the increasing aspirations of the international community for AEOI to enhance tax transparency, and the need to maintain Hong Kong's competitiveness as an international financial centre, it is necessary for Hong Kong to put in place the necessary legal framework for AEOI implementation. The Administration points out that the Global Forum will conduct a peer review on members regarding AEOI implementation from 2017 onwards. It will be crucial for Hong Kong to pass the peer review to avoid being labelled as an uncooperative tax jurisdiction and the possibility of having sanctions imposed on Hong Kong unilaterally. Although Hong Kong's tax regime is territorial-based, Hong Kong can benefit from implementing AEOI on a reciprocal basis since it may enable IRD to obtain more comprehensive financial information of Hong Kong taxpayers, so as to facilitate IRD's assessment and recovery of tax in default from some Hong Kong taxpayers.

11. The Administration has further advised that while AEOI is the latest standard of EOI promulgated by OECD and conducting AEOI on a bilateral basis is permissible by OECD so far, OECD has released in October 2015 a final package of measures under the Base Erosion and Profits Shifting Project, which was endorsed by the Group of Twenty ("G20") at the Leaders' Summit in mid-November 2015. In connection with this development, there will be pressure for Hong Kong to be covered by the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, and to conduct AEOI on a multilateral basis. Notwithstanding this, the Administration's current approach remains to conduct AEOI on a bilateral basis in order to take forward this new initiative in an orderly and gradual manner. It will keep a close watch on any further development in respect of the Multilateral Convention and map out the relevant strategy and response when appropriate.

12. The Bills Committee notes that subject to enactment of the Bill in about mid 2016, the Administration will identify potential AEOI candidates and aim to conclude CAA negotiations with the first batch of AEOI partners by the end of 2016. This is to pave the way for FIs to start conducting due diligence procedures in respect of their financial accounts in 2017. The first exchanges of information with Hong Kong's AEOI partners are scheduled for September 2018.

Scope of AEOI

13. The Bills Committee notes that, for the purpose of implementing AEOI, FIs comprise custodial institutions, depository institutions, specified insurance companies, and investment entities; and only FIs which are resident in Hong Kong or a branch of an overseas FI located in Hong Kong (i.e. reporting FIs ("RFIs")) will be subject to the reporting requirements.

Non-reporting financial institutions and excluded accounts

14. CRS provides that certain FIs and accounts (known as "non-reporting FIs" and "excluded accounts" respectively), which present a low risk of being used for tax evasion, can be exempted from reporting. CRS also allows jurisdictions to identify additional items for exemptions, subject to certain stringent criteria.[3] Based on the criteria, the Administration has proposed that apart from providing for the "non-reporting FIs" and "excluded accounts" set out in CRS, the Hong Kong Monetary Authority and its pension fund, the Grant Schools Provident Fund and Subsidized Schools Provident Fund, as well as the Mandatory Provident Fund Schemes, the Occupational Retirement Schemes and the Credit Unions registered under the relevant ordinances be incorporated into "non-reporting FIs", and dormant accounts into "excluded accounts". The lists of "non-reporting FIs" and "excluded accounts" are set out in the new Schedule 17C.[4] The Bills Committee further notes that as stipulated by CRS, a jurisdiction cannot define an entity as a "non-reporting FI" solely because it is a non-profit-making organization.

Reportable jurisdictions

15. Reportable jurisdictions refer to jurisdictions with which Hong Kong has entered into either CDTA or TIEA as well as CAA for the conduct of AEOI. Upon commencement of the Amendment Ordinance, IRD will enter into CAAs

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[3] The criteria are: (a) whether or not the FI/account presents a low risk of being used for tax evasion; (b) whether it bears substantially similar characteristics to any "non-reporting FIs" or "excluded accounts" under CRS; and (c) whether it is subject to regulation or some form of information reporting to the tax authority.

[4] The Secretary for Financial Services and the Treasury ("SFST") may amend the new Schedule 17C by notice in the Gazette, subject to negative vetting by LegCo.

and the AEOI partners (i.e. the reportable jurisdictions) will be listed in the new Schedule 17E by way of notice in the Gazette.[5] The Bills Committee has sought the criteria for identifying potential AEOI candidates from Hong Kong's existing or future CDTA/TIEA partners.

16. The Administration has advised that in principle, the potential AEOI candidates should have the capability in meeting the OECD standard and relevant safeguards in their domestic law for protecting data privacy and confidentiality of the information exchanged. The Administration will also take into account the bilateral trade relationship with the potential AEOI candidates, and the outcome of assessments arising from the review being conducted by the Global Forum regarding the confidentiality and data safeguards of the jurisdictions committed to implementing AEOI. The Administration will be open to suggestions from stakeholders on the priorities for AEOI negotiations.

Obligations of reporting financial institutions

Information to be furnished by reporting financial institutions to the Inland Revenue Department

17. The new section 50C provides for the obligations of reporting FIs to furnish returns to IRD while the new section 50F stipulates the information to be furnished in the returns, such as the name, address, jurisdiction(s) of residence, taxpayer identification number(s) ("TIN(s)") and date and place of birth of each reportable person (whether the account holder is an individual or is an entity with one or more controlling persons that is a reportable person), and the account balance.[6]

18. The Bills Committee considers that as Hong Kong's tax regime is territorial-based, the general public may not be familiar with how to ascertain their tax residences in relation to AEOI. In particular, returned overseas Hong Kong migrants and persons who are previously tax residents of certain jurisdictions outside Hong Kong may be confused as to whether they are/remain the tax residents of a certain reportable jurisdiction. The Bills Committee has urged the Administration to explain clearly the AEOI requirements and tax residency rules to the public and RFIs.

19. The Administration has advised that in general, whether an individual is a tax resident of a jurisdiction is determined having regard to the person's

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[5] SFST may amend the new Schedule 17E by notice in the Gazette, subject to negative vetting by LegCo.

[6] According to CRS, the definition of TIN may include a functional equivalent. TIN to be collected in each jurisdiction is different. The OECD website has listed the TIN information of various jurisdictions for reference by account holders.

physical presence or stay in a place (say, whether over 183 days within a tax year) and not his citizenship, right of abode or nationality. In the case of a company, the test is the place of incorporation or where the central management and control of the entity lies. That a person has paid taxes charged by a jurisdiction does not automatically render that person a tax resident of that jurisdiction. The tax residence of individual account holders may change from one year to another and the tax laws may differ amongst jurisdictions. The Administration has stressed that it is the responsibility of individual account holders to ascertain their own tax residences, and to notify the RFIs concerned of any changes in this regard. The public may refer to the OECD portal which provides information regarding tax residency rules application in jurisdictions that are committed to implementing AEOI. IRD has also uploaded a set of frequently asked questions onto its website to succinctly explain, with examples, the operation and requirements of AEOI, and it will continue to update the relevant information in a timely manner. The Administration has assured members that it will liaise with RFIs and take forward publicity of AEOI.

20. The Bills Committee further notes that account holders will not be required to provide information on their past tax residence(s). If the tax authority of a reportable jurisdiction requests information on an account holder in Hong Kong who is no longer a tax resident of that jurisdiction, the request can be raised and considered separately under the existing regime of EOI upon request in the context of CDTA or TIEA.

Due diligence procedures

21. The new section 50B provides for an obligation on RFIs to establish, maintain and apply due diligence procedures set out in the new Schedule 17D,[7] which follow the CRS requirements in general. An RFI may engage a service provider to carry out the RFI's due diligence and reporting obligations in relation to AEOI, but the RFI is not relieved from its due diligence or reporting obligations. At the request of the Bills Committee, the Administration has provided for members' reference information on a comparison of the major provisions of the Bill and CRS,[8] and a summary of the due diligence procedures.[9]

22. The Bills Committee notes that the due diligence procedures can in general be classified into two types:

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[7] The new Schedule 17D may be amended by SFST by notice in the Gazette, subject to negative vetting by LegCo.

[8] Annex to the Administration's reply to the letter dated 26 January 2016 from the Legal Adviser to the Bills Committee, which was issued for the meeting of the Bills Committee held on 2 February 2016 vide LC Paper No. CB(1)528/15-16(01).

[9] Annex to the Administration's paper issued for the meeting of the Bills Committee on 1 March 2016 vide LC Paper No. CB(1)611/15-16(02).

(a) *New accounts (i.e. opened on or after 1 January 2017)*: RFIs have to request individual and entity account holders to submit self-certifications. Account holders have to provide information regarding their own tax residences, so that the RFIs are able to verify whether the accounts are reportable accounts.

(b) *Pre-existing accounts (i.e. opened before 1 January 2017)*: CRS has set out the required procedures for identifying whether an account holder is a resident for tax purposes in a reportable jurisdiction regarding low value individual accounts, high value individual accounts and entity accounts respectively. In gist, CRS has provided for more stringent requirements for high value pre-existing accounts.[10] In case there is anything unclear, FIs can request account holders of low value or high value individual accounts to provide self-certifications.

23. The Administration has highlighted that the Bill mandates RFIs to identify and collect information of accounts held by tax residents of the reportable jurisdictions only, but it also allows a wider approach under which RFIs may, in carrying out the requirements of due diligence obligations, apply the same procedures for accounts the holders of which are, for tax purposes, residents of any other jurisdictions outside Hong Kong (i.e. not only those of the reportable jurisdictions). This is intended to provide flexibility for RFIs in choosing an approach which fits their circumstances, whilst providing RFIs with a clear legal basis to pursue this wider approach in identifying and collecting the information in respect of accounts which are not reportable accounts.

24. The Bills Committee notes that certain accounts are exempted from due diligence if they meet the respective thresholds in terms of the aggregate account balance or value, and other criteria as applicable. On whether the said thresholds can be aligned or adjusted, the Administration has advised that the relevant thresholds are set in accordance with CRS. If the Administration takes the liberty to align or adjust the thresholds, which will depart from the

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[10] For instance, regarding low value individual accounts, an RFI has to identify whether the account holders are residents for tax purposes of a reportable jurisdiction having regard to the current residence address for the account holders in its records based on documentary evidence; or review electronically searchable data maintained by the RFI to find out certain indicia stipulated in CRS (such as the identification of the account holder as a resident for tax purposes of a reportable jurisdiction, whether the telephone number or current residence address is within a reportable jurisdiction) to identify if the accounts are reportable accounts. As for high-value individual accounts, apart from electronic record search and paper record search, RFIs are also required to conduct the identifying procedures through relationship manager inquiry for actual knowledge test.

CRS requirements, Hong Kong will not be able to meet the relevant international standard.

Exercising reasonable due diligence by reporting financial institutions

25. The Bills Committee has enquired about how RFIs will be taken as having exercised all reasonable due diligence to identify the tax residences of account holders. There is a concern about the difficulty for RFIs to identify reportable accounts, such as where the account holders refuse to provide information, or the accounts are pertaining to a trust or estate with a number of beneficiaries and who may be infants or minors.

26. The Administration has advised that self-certification will serve an important tool for RFIs to fulfill their reporting and due diligence obligations, in particular to determine the tax residences of account holders. In the case of a trust, the trustee has to provide information of the controlling person (including the beneficiary) in the self-certification to the RFI. The RFI concerned should report discretionary beneficiaries in the year they receive distributions from the trust. Prior to the distribution, the RFI must have appropriate procedures in place to identify the beneficiaries and determine their jurisdictions of residence, including those of infants or minors.

27. The Administration has stressed that RFIs are not expected to carry out independent legal analyses of relevant tax laws or carry out investigation to determine the tax residence of the account holders. Should any part of the self-certification be apparently in conflict with the information held by RFIs, new self-certification or explanation from the account holder should be sought. If, after having exercised all reasonable due diligence, the RFIs are still unable to obtain self-certification or documentary evidence to determine certain account holders' tax residence under particular circumstances, the RFIs should treat such accounts as undocumented accounts and report to IRD. IRD will promulgate guidelines, which will include a sample self-certification form for RFIs' reference, and brief RFIs regarding the due diligence and reporting requirements. The Administration has also advised that it will not restrict RFIs' design on the format of the self-certification.

Compliance burden on reporting financial institutions

28. Members have expressed concerns about whether the AEOI-related due diligence requirements will create undue compliance burden on RFIs. Some members consider that the Administration should exercise a flexible and lenient approach in handling RFIs' non-compliances at the initial stage of AEOI implementation. Mr Christopher CHEUNG has requested the Administration to take into account the views of small and medium-sized RFIs when drawing up industry guidelines relevant to AEOI. Mr Kenneth LEUNG considers that

RFIs may build or strengthen their rapport with representatives from OECD or G20, and convey any concerns or suggestions to them on the implementation of AEOI.

29. The Administration has advised that RFIs are obliged to start collecting information from account holders who are 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. RFIs will then report the information to IRD in the next calendar year. This timeframe should allow ample time for RFIs to collect and report the reportable information. As AEOI in Hong Kong will be implemented in a progressive manner (with only a few AEOI partner jurisdictions at the initial stage), and leveraging on similar experiences gained from implementation of the Foreign Account Tax Compliance Act of US, it is envisaged that AEOI will not give rise to undue compliance burden on RFIs.

30. The Administration has further advised that under the existing Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615), FIs are already 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 RFIs in carrying out the due diligence procedures for AEOI, CRS allows RFIs to resort to information collected pursuant to such procedures for the purpose of identifying or ascertaining the tax residences of account holders.[11] Furthermore, the Bill has incorporated various alternative options permissible under CRS to provide RFIs with greater flexibility to conduct due diligence procedures.[12] IRD will draw up clear guidelines or departmental instructions and practice notices to facilitate the implementation of the arrangements by the industry.

Enforcement of the AEOI regime

31. The Bills Committee notes that for enforcement of the AEOI regime, the Bill empowers IRD to:

(a) have access to the business premises of an RFI or a service provider (if any) and inspect its compliance system and process (if

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[11] Specifically, if RFIs have already collected certain residence proof information of account holders in accordance with the existing anti-money laundering/know-your-customer procedures and that information shows updated residence addresses of the account holders, RFIs can continue to seek and rely on such information to identify the tax residence of their account holders, and there is no need to request the account holders to separately provide other types of residence proof.

[12] For instance, the definition of "pre-existing account" is expanded to cover "new accounts" opened by pre-existing customers if certain conditions are met, so that RFIs can adopt the same procedures for both types of accounts.

the inspection is reasonably required for the purpose of checking its compliance with the due diligence and reporting obligations, and upon prior notice by IRD) and, if any non-compliance is found during such inspection, require the RFI or service provider to rectify the system or process to secure compliance (i.e. new section 51BA); and

(b) obtain search warrant where an RFI or its service provider fails to comply with the court order directing it to comply with the return filing requirement; and where access to and inspection of any places or any books, records, or information or data in relation to the compliance system and process is required because there is reasonable ground for suspecting that the RFI or its service provider has failed to comply with the due diligence or return filing requirements without reasonable excuse and not through an innocent oversight or omission (i.e. proposed amended section 51B).

Search warrant for accessing the premises of reporting financial institutions

32. Mr Andrew LEUNG has expressed concern that the issue of search warrant for IRD to access the premises of an RFI or its service provider due to non-compliance with the due diligence requirements etc. for AEOI may be disproportionate to the relatively light nature of the non-compliance compared to tax evasion. The Bills Committee also notes that under the new section 51B(1AAAB), IRD may apply for the search warrant if the search may afford evidence material in assessing the liability of the RFI or its service provider (if any), or of any other person for tax of a reportable jurisdiction. The Bills Committee has requested the Administration to clarify why "the liability of a person for tax of a reportable jurisdiction" is not among the matters stipulated in the new section 51B(1AAA) which the Commissioner of Inland Revenue or authorized officer must satisfy a magistrate for the purpose of obtaining a search warrant.

33. The Administration has advised that same as IRD's current practice in applying search warrants from the magistrate,[13] IRD will only apply for the

[13] According to the existing section 51B, the Commissioner of the Inland Revenue or his authorized officer may apply to the magistrate for a search warrant under the following conditions: (a) there are reasonable grounds for suspecting that a person has made an incorrect return or supplied false information having the effect of understating his income or profits chargeable to tax and has done so without reasonable excuse and not through an innocent oversight or omission; or (b) a person has failed to comply with an order of a court made under section 80(1) or (2A) directing him/her to comply with the requirements to furnish a return. Section 51B also applies to the taxes of tax jurisdictions with which Hong Kong has signed CDTAs or TIEAs.

search warrants regarding the relevant RFI or its service provider under those circumstances specified in the proposed amended section 51B. Moreover, IRD will make such applications only if necessary.

34. The Administration has further advised that "the liability of a person for tax of a reportable jurisdiction" has been covered by the matters which the magistrate has to be satisfied, i.e. that there are reasonable grounds for suspecting that an RFI or its service provider has failed to comply with the new section 50B(1) or (2) or 50C(1). These provisions involve the due diligence obligations on an RFI or its service provider in establishing or maintaining procedures to identify whether a financial account is a reportable account, i.e. identify whether the account holder is a resident for tax purposes of a reportable jurisdiction.

New section 50K

35. The new section 50K provides for the use of reportable information furnished by RFIs for the administration of IRO. The Bills Committee notes that some deputations have queried whether this provision may in effect expand the powers of IRD to use information collected under AEOI for domestic and non-AEOI purposes. The Administration explains that at present, IRD may administer and enforce the relevant provisions of IRO having regard to the information furnished by the relevant persons in accordance with IRO. The new section 51K is added to IRO only to avoid doubt.

Sanctions

36. The Bill includes penalty provisions in relation to the following parties to provide for deterrent effects to ensure effective implementation of the AEOI regime in Hong Kong:

(a) RFIs (i.e. new section 80B);

(b) service providers engaged by RFIs to fulfill certain specified due diligence and reporting obligations of RFIs (i.e. new section 80D);

(c) employees of, or persons engaged to work for, RFIs (i.e. new section 80C); and

(d) account holders who, in making a self-certification, makes a statement that is misleading, false or incorrect in a material particular; and knows, or is reckless as to whether, the statement is misleading, false or incorrect in a material particular (i.e. new section 80(2E)).

Offence relating to the making of self-certification that is misleading, false or incorrect under the new section 80(2E)

37. Some members are concerned that the proposed imposition of criminal sanction against the offence of providing misleading/false/incorrect information in a self-certification may not be justified because, unlike the provision of information to the Government, account holders may not be aware of their legal liabilities when providing information to RFIs, and they may be caught by the offence inadvertently. Moreover, some account holders may not be familiar with the legal concept of tax residence in jurisdictions outside Hong Kong. Mr James TO has queried whether IRD may, before commencing criminal proceedings, exercise its information gathering powers under the existing provisions of IRO (such as section 80) to request an account holder, who is suspected of making false self-certification, to provide certain information in respect of the self-certification made, such that the person will not be able to make a defence or exercise his/her right to silence under such circumstances. This will risk undermining the person's privilege against self-incrimination. He is also concerned that RFIs may request IRD to exercise its statutory powers to force account holders to provide information in order to fulfill the RFI's AEOI-related obligations. Mr TO has suggested that:

(a) where there is reasonable doubt, IRD should seek confirmation from the account holder concerned on the self-certification made; or the RFI should ask the account holder to provide a self-certification again. Only if the account holder provides incorrect information when making confirmation with IRD on the self-certification made or when making a further self-certification to the RFI, should IRD then take enforcement actions; and

(b) the Administration should consider adding a provision in the Bill to stipulate explicitly that the Administration cannot rely solely on the self-certification provided by an account holder to establish that the person concerned commits an offence under the new section 80(2E).

38. To further address the concern about inadvertent omission or error made by account holders when making self-certification, Mr James TO and Mr Kenneth LEUNG have suggested putting in place measures to alert account holders of the need to exercise caution in making self-certification and their legal liabilities. Given the risk that errors may occur during the transmission of data from RFIs to IRD or from IRD to the tax authorities of reportable jurisdictions, the Hong Kong Institute of Certified Public Accountants considers that a mechanism may be put in place to notify account holders the information furnished by RFIs to IRD for AEOI purpose, and/or the account holders should have the right to access relevant information that has been passed by RFIs to

IRD or by IRD to the overseas tax authorities, such that the account holders will have the opportunity to correct the information if necessary.

39. The Administration has advised that the proposed penalty is considered necessary and appropriate, and in line with CRS which provides that a jurisdiction must have rules and procedures to ensure effective implementation of AEOI, and jurisdictions are expected to include a specific provision in their domestic law imposing sanctions for making a false self-certification, so as to increase the reliability of self-certification. The Administration has also made reference to similar penalty provisions in other jurisdictions and the existing penalties under IRO.[14] The Administration points out that the self-certification form will include reminder(s) or warning(s) to caution an account holder about his/her legal liabilities in making self-certification. Under the Personal Data (Privacy) Ordinance (Cap. 486) ("PDPO"), account holders are also entitled to making request to RFIs for access to and correction of their personal data.

40. The Administration has further advised that:

(a) even if an account holder, in making a self-certification, provides misleading, false or incorrect information in a material particular, the Administration will not and cannot rely only on the self-certification provided by the account holder to establish that the person concerned commits an offence. According to the new section 80(2E), the account holder will commit an offence only if it has been proved that he/she knows, or is reckless as to whether, the statement is misleading, false or incorrect in a material particular. It will be a high prosecution threshold as IRD must prove not only the *actus reus* but also the *mens rea* of "knowingly" or "recklessly". The Administration has to conduct investigation in the first place before being in a position to establish whether there are sufficient grounds to take prosecution actions;

(b) in actual operation, if IRD receives information showing that an account holder may have provided a misleading, false or incorrect self-certification, IRD will contact the relevant RFI to ascertain if it has carried out the due diligence procedures required or otherwise. If necessary, IRD will contact the relevant account holder and examine the information in the self-certification provided by that person, including requesting the person to provide information on his tax residence, so as to establish whether the information in the self-certification is correct or not in the first place. During the

[14] For instance, section 80(2D) is about providing incorrect information in relation to a government of a territory outside Hong Kong with which Hong Kong has entered into an arrangement having effect under section 49(1A).

process, the person concerned can provide further information and explanation to IRD to assist in the investigation. Even if the person has admitted that there are errors in the information provided earlier, and then provided updated or other information in accordance with IRD's request, IRD still has to prove that the account holder provided incorrect information knowingly or recklessly in the first place before IRD can consider taking any prosecution action;

(c) when IRD raises questions with the account holder during investigation, IRD does not need to rely on the statutory powers specified in section 80 but will follow the "Rules and Directions for the Questioning of Suspects and the Taking of Statements". In the absence of any actual case in context and given that each case should be considered having regard to its actual circumstances, the Administration considers that it is not in a position to commit not to make use of section 80 to gather information from the account holder;

(d) if IRD has reasonable cause to suspect that the account holder has committed an offence, IRD will caution the account holder and remind that account holder that he or she has the right to keep silent. The person concerned can choose to keep silent when he or she is asked for explanation regarding the self-certification; and the person will not be regarded as breaching section 80 if he or she keeps silent when being questioned about the self-certification. As account holders do not need to provide any information to the Government direct in relation to AEOI, there is no question of RFIs requesting IRD to exercise its statutory powers to request account holders to provide the information; and

(e) above all, if the Bill provides that an account holder can confirm with IRD again on the self-certification made, or make a self-certification again to an RFI, after IRD has commenced investigation, and that no offence will be committed so long as the person can provide correct information when making confirmation with IRD or making the further self-certification to the RFI, it will render the proposed sanction futile, and will also affect the effective implementation of the whole AEOI regime.[15]

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[15] According to the Administration's study on the overseas legislations for AEOI, no other tax jurisdiction has provided statutory provisions which allow an account holder to confirm with the tax authority the self-certification provided to FIs.

41. In essence, the Administration considers that the proposed offence provision in the new section 80(2E) and the arrangements explained in paragraph 40 above have already achieved the following effects and it is not necessary to amend the said offence provision or introduce additional provisions:

(a) IRD cannot solely rely on the self-certification to establish that a person has committed an offence, unless the two prescribed conditions (namely, (i) the account holder, in making the self-certification, makes a statement that is misleading, false or incorrect in a material particular; and (ii) knows, or is reckless as to whether, the statement is misleading, false or incorrect in a material particular) are both met; and

(b) the account holder has the opportunity to defend his/her position when making explanation to IRD, and has the right to keep silent as well.

42. Mr James TO is not content with the Administration's explanation and has indicated his intention to move Committee Stage amendments ("CSAs") to the offence provisions relating to the making of a self-certification that is misleading, false or incorrect.

Applicability of the offence under the new section 80(2E) to self-certification collected at the option of reporting financial institution

43. Under section 4(a) of Part 2 of the new Schedule 17D, an RFI may elect to apply the due diligence requirements for new accounts to pre-existing accounts, i.e. to request an account holder of a pre-existing account to provide self-certification which is otherwise not required under the Schedule. The Bills Committee has sought clarification on whether a self-certification collected at the option of the RFI will not be one that is required to be collected under Schedule 17D and hence the maker of such self-certification which is misleading, false or incorrect will not be subject to the sanction under the new section 80(2E).

44. The Administration has explained that the new section 80(2E) is applicable to a "self-certification that is required to be collected under the new Schedule 17D by a reporting financial institution" as made by account holders. Schedule 17D sets out the due diligence requirements, as laid down in CRS, which an RFI has to establish, maintain and apply in respect of accounts of different categories. These cover the circumstances under which an RFI must or may take appropriate procedures, including that of obtaining self-certifications from account holders, to identify whether a financial account

is a reportable account. In other words, section 80(2E) will apply to self-certifications made by account holders as required by the RFI (including those collected following the relevant procedures as opted by the RFI) in accordance with such due diligence requirements set out in Schedule 17D.

How certain information provided to the Inland Revenue Department is regarded as "misleading, false or inaccurate"

45. Some members have reservations as to how the Administration can prove whether an account holder or RFI has provided certain information that is "misleading, false or inaccurate" in relation to the proposed offences of account holders and RFIs under the new sections 80(2E) and 80B respectively. In particular, these members consider it difficult to ascertain whether certain information is "misleading".

46. The Administration has advised that under the AEOI arrangement, the scope of information required to be provided by account holders to RFIs and that required to be provided by RFIs to IRD are limited and are drawn up in accordance with the specific requirements of CRS. When working on the formulation of "information that is misleading, false or inaccurate", the Administration has made reference to relevant local and overseas legislation. The penalty provision of the new section 80(2E) or 80B adopts the wording of "misleading", "false" and "incorrect" (or "inaccurate"), which generally follows the existing section 80 (about penalties for failure to make returns or making incorrect returns).[16] In practice, whether certain information is misleading, false or inaccurate is to be determined by the court based on the actual circumstances of each case. For instance, if certain information in a material particular is missing in a statement, and such omission makes others wrongly believe that what is provided in the statement is the whole truth about the fact, this may constitute a misleading statement. From the successful prosecution cases made under section 80,[17] the Bills Committee notes that there are no cases involving the provision of "misleading" information in recent years, which may reflect the greater difficulty in establishing the case for offence on such basis, when compared with the provision of "false" or "incorrect" information.

Sanctions on service providers engaged by reporting financial institutions

47. Under the new section 80D(1) to (3), a service provider engaged by an

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[16] The wording of "misleading", "false" and "incorrect" is adopted in certain provisions under section 80 (about penalties for failure to make returns, making incorrect returns, etc.). They include section 80(1AB) which adopts the wording of "false or misleading" and section 80(2) and section 80(2D) which adopt the wording of "incorrect".

[17] Annex B to the Administration's paper issued to the Bills Committee on 3 May 2016 vide LC Paper No. CB(1)871/15-16(02).

RFI commits an offence if the person, without reasonable excuse, fails to fulfill the RFI's obligations under section 50B(1), 50B(2) or 50C(1). The new section 80D(4) further provides, among other things, that the service provider commits an offence if the person causes or allows the RFI to provide, or in purported compliance with the requirement on the RFI to furnish a return under section 50C(1), provides any information in the return to IRD that is misleading, false or inaccurate in a material particular, and knows, or is reckless as to whether the information is misleading, false or inaccurate in a material particular; or has no reasonable ground to believe that the information is true or accurate, etc., whereas the new section 80D(7) provides for an offence of the service provider if the person, with intent to defraud, causes or allows the RFI to provide information that is misleading, false or inaccurate in a material particular in the return furnished to IRD.

48. Mr James TO, Mr Kenneth LEUNG and Mr SIN Chung-kai have expressed concerns that the proposed offences are unfair to the service providers as they may act according to RFIs' instructions only. In particular, these members consider the offences under the new section 80D(1) to (3) unreasonable as they appear to be strict offences. There is a view that the failure of a service provider to fulfill an RFI's obligations in relation to AEOI should be a matter of the contractual arrangement between the RFI and the service provider, and hence should be subject to civil liabilities; and service providers should be held liable only if they fail to meet the relevant requirements knowingly or recklessly. Mr Kenneth LEUNG has requested the Administration to consider whether the offence provisions in respect of service providers can be removed in the light that no offences are currently imposed under the existing section 80 for similar contexts (e.g. engagement of service providers such as accountants or tax consultants by taxpayers and reporting of tax liabilities by taxpayers or their agents to IRD under IRO); and the contractual arrangement between an RFI and its service provider normally includes provisions governing the service provider's liabilities in the event of its failure to carry out the RFI's obligations under the Bill. Mr LEUNG has cautioned the Administration that the proposed offences of service providers may render it difficult for RFIs to procure services in relation to AEOI. Mr LEUNG has also indicated that he may propose CSAs to the Bill in relation to the offences of service providers.

49. The Administration has advised that when handling their day-to-day operations, it is very common for FIs to engage service providers. Relevant regulatory authorities (such as the Hong Kong Monetary Authority, Office of the Commissioner of Insurance and Mandatory Provident Fund Schemes Authority) have provided guidelines regarding the engagement of service providers by FIs. In the context of AEOI, the actual scope of service covered by each service provider engaged by individual RFIs may vary, depending very

much on the latter's specific requirements,[18] and the RFIs may engage one or more service providers. The relevant service providers may be solely or jointly liable, depending on the actual circumstances and facts of specific cases.

50. The Administration has further advised that since a service provider may be engaged by an RFI to take up the obligations specified in the Bill, and these obligations are crucial for Hong Kong to deliver its obligations for AEOI, it is essential to put in place relevant offence provisions in respect of service providers, so as to avoid their non-compliance which will affect the implementation of AEOI arrangement. This situation is essentially different from the reporting of tax liabilities to IRD under IRO.[19] The Administration has also stressed that even if a service provider is engaged, the RFI is not relieved from its due diligence and reporting obligations, as provided in the new section 50H. Further, while the relevant legislations of overseas jurisdictions such as UK and Ireland have not provided for any penalties specifically for service providers, the general penalty provisions are applicable to service providers. Having regard to the feedback collected in the consultation that penalty provisions for different parties should be clearly set out in the law, the Bill has stipulated respective penalty provisions regarding all relevant parties (i.e. RFIs, RFIs' employees and service providers) in the context of AEOI.

51. As regards the concerns on whether the offences against service providers are too strict and unfair to service providers, the Administration has advised that it is for this consideration that "without reasonable excuse" is included in the new section 80D, so that a service provider engaged to carry out an RFI's obligations under section 50B or 50C will commit the offence only if it, without reasonable excuse, fails to establish, maintain or apply due diligence procedures or furnish returns as required. As regards the offence against a service provider's provision of any information in the returns that is misleading, false or inaccurate in a material particular, whether the service provider is liable for the offence will be subject to whether the service provider is proved to have provided such information knowingly or in a reckless manner.

52. The Administration has further advised that the proposed penalty level on service providers is drawn up after thorough consideration. In general, if a service provider fails to comply with its relevant obligations without reasonable excuse, or provides information that is misleading, false or inaccurate in a

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[18] In terms of actual operation, the scope of services which can be provided by service providers to RFIs may range from the development of operational manuals, performance of customer due diligence measures, development of information technology solutions and generation of data files, to actual reporting of the relevant information to IRD.

[19] While a taxpayer may engage an agent as his/her tax consultant under IRO, the agent cannot sign on the tax return on behalf of the taxpayer or furnish the tax return on behalf of the taxpayer to IRD.

material particular in a return knowingly or in a reckless manner, the penalty is a fine at level 3 (i.e. $10,000). The service provider providing misleading, false or inaccurate information in a material particular in a return may be subject to imprisonment only if it does so with intent to defraud. The above proposed arrangement is in line with the penalty level provided under the existing IRO. In sum, the Administration considers that the proposed offence provisions have struck a balance between facilitating the practical operation of RFIs and ensuring effective implementation of AEOI arrangement.

Safeguarding taxpayers' rights and confidentiality of information exchanged

Provision of safeguards in the legislation

53. The Bills Committee notes that the Bill per se does not contain any proposals to provide safeguards under domestic legislation relating to taxpayers' privacy and confidentiality of the tax information exchanged under AEOI nor contain any empowering provisions to make subsidiary legislation to such effect. While the existing Inland Revenue (Disclosure of Information) Rules (Cap. 112BI) ("the Disclosure Rules") provide certain procedural rights and safeguards for persons affected by the information exchange (e.g. a notification and review system in handing EOI requests and related appeals), the Rules are only applicable to a request for disclosure of information and thus the relevant safeguards will not be applicable to taxpayers under AEOI arrangements. The Bills Committee has therefore enquired about:

(a) the legal provisions to protect taxpayers' privacy and confidentiality of the tax information exchanged under AEOI;

(b) whether the holders of reportable accounts will be informed of the possible use of information collected from them for AEOI purposes;

(c) measures to protect taxpayers' interests if Hong Kong's AEOI partner jurisdictions breached the relevant safeguards provisions; and

(d) whether the AEOI arrangement will provide for a notification and review system, similar to the system provided under the Disclosure Rules.

54. The Administration explains that currently, the EOI article of CDTA and relevant articles of TIEA provide for safeguards to protect taxpayers' privacy and confidentiality of information exchanged. Given that, in practice, AEOI will be implemented with CDTA and TIEA partners under the respective CDTA or TIEA, the safeguards for EOI will be equally applicable to information

exchanged under the AEOI mode. Such safeguards at the treaty level are set out in **Appendix III**. Separately, 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 or terminate CAA by giving notice in writing to the other competent authority if there is or has been significant non-compliance by the other competent authority. In the context of Hong Kong, termination of a CAA may take immediate effect pending completion of negative vetting by LegCo of the subsidiary legislation that removes the jurisdiction from the relevant schedule to IRO. Mr NG Leung-sing suggests that OECD should make public a list of tax jurisdictions with non-compliance record in AEOI for reference by other tax jurisdictions. The Administration has agreed to relay this suggestion to OECD.

55. As regards whether it is feasible to provide for a notification and review system in handling AEOI-related appeals, the Administration has advised that it is not aware of any similar notification and review system by the competent authorities of other jurisdictions for AEOI. If a notification and review mechanism is in place, it will unduly delay the implementation of AEOI, thus rendering Hong Kong unable to meet the tight timeline for annual exchange with various AEOI partners as required under the OECD standard. Having regard to the concerns, the Administration has communicated with FI groups and reminded them to take appropriate measures, including amending the 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; and taking all practicable steps to ensure that the personal data is accurate and that account holders will be allowed to review and correct their personal and financial data.

56. The Bills Committee further notes that use of information exchanged under AEOI for criminal proceedings (i.e. non-tax related purposes) will not be allowed unless authorized by IRD having regard to the requirements of the local legislation (e.g. the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615)).

Protection of personal data

57. The Bills Committee notes that by virtue of section 58(1)(c), (1A) and (2) of PDPO, the collection of personal data from RFIs, and the exchange of such information by IRD with the tax authority of another jurisdiction with which Hong Kong has signed either a CDTA or TIEA as provided for under section 49(1A) of IRO is exempt from the Data Protection Principles 3 and 6 of PDPO. Nevertheless, RFIs should comply with the existing requirements

under the data protection principles in Schedule 1 to PDPO. For instance, they should inform the account holders of the possible use of the information collected for AEOI purposes and that all practicable steps must be taken by the account holders to ensure that the personal data are accurate.

Drafting issues

58. The Bills Committee has noted the enquiries raised by the Legal Adviser to the Bills Committee on certain drafting issues of the Bill,[20] and the Administration's response on those issues.[21]

Committee Stage amendments

59. The Bills Committee and the Administration have not proposed any CSAs to the Bill. The Bills Committee has noted that Mr James TO intends to move CSAs to the proposed offence provisions relating to the making of a self-certification that is misleading, false or incorrect. Mr Kenneth LEUNG has indicated that he may propose CSAs in relation to the offences of service providers.

Resumption of Second Reading debate

60. The Bills Committee has no objection to the resumption of the Second Reading debate on the Bill at the Council meeting of 8 June 2016.

Advice Sought

61. Members are invited to note the deliberations of the Bills Committee above.

Council Business Division 1
Legislative Council Secretariat
26 May 2016

[20] Issued vide LC Paper Nos. CB(1)830/15-16(01) and CB(1)830/15-16(03).
[21] Issued vide LC Paper Nos. CB(1)830/15-16(02) and CB(1)849/15-16(01).

Appendix I

Bills Committee on Inland Revenue (Amendment) Bill 2016

Membership list

Chairman	Hon Andrew LEUNG Kwan-yuen, GBS, JP
Members	Hon James TO Kun-sun Hon Jeffrey LAM Kin-fung, GBS, JP Hon WONG Ting-kwong, SBS, JP Hon CHAN Hak-kan, JP Hon Mrs Regina IP LAU Suk-yee, GBS, JP (since 22 March 2016) Hon NG Leung-sing, SBS, JP Hon Charles Peter MOK, JP Hon Kenneth LEUNG Hon Dennis KWOK Hon Christopher CHEUNG Wah-fung, SBS, JP Hon SIN Chung-kai, SBS, JP (Total: 12 members)
Clerk	Ms Angel SHEK
Legal Adviser	Ms Clara TAM

Appendix II

Bills Committee on Inland Revenue (Amendment) Bill 2016

List of organizations from which the Bills Committee has received views

1. Asia Securities Industry & Financial Markets Association
2. Hong Kong Institute of Certified Public Accountants
3. Hong Kong Investment Funds Association
4. Hong Kong Trustees' Association

*5. International Chamber of Commerce – Hong Kong, China

*6. The Association of Hong Kong Accountants

*7. The Chinese General Chamber of Commerce

8. The Hong Kong Association of Banks

*9. The Hong Kong Federation of Insurers

10. The Institute of Certified Management Accountants (Hong Kong Branch)

11. STEP Hong Kong Ltd

* views given by written submission only

Appendix III

Safeguards at the treaty level

(a) The information exchanged should be foreseeably relevant, i.e. there will be no fishing expeditions;

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

(c) Information will only be disclosed to the tax authorities and not for release to their oversight bodies unless there are legitimate reasons given by partners of comprehensive avoidance of double taxation agreement ("CDTA") or tax information exchange agreement ("TIEA") (i.e. the inclusion of any such oversight bodies must be positively listed);

(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 will be covered by legal professional privilege, etc.;

(f) The use of information exchanged for other purposes (i.e. non-tax related) should be allowed provided that such use is allowed under the laws of both contracting parties and the competent authority of the supplying party authorises such use. In other words, it is a prerequisite that exchange of information must first be conducted for tax purposes in accordance with the provisions of a relevant CDTA/TIEA. As envisaged by the Organization for Economic Cooperation and Development, the sharing of tax information exchanged is only meant for certain high priority matters (such as to combat money laundering, corruption and terrorism financing); and

(g) No requests from treaty partners will be acceded to for tax examinations abroad (i.e. such an article is not included in Hong Kong's CDTAs/TIEAs).

[*Source*: Adapted from Annex C to Legislative Council Brief on the Inland Revenue (Amendment) Bill 2016]