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Bills Committee on Inland Revenue (Amendment) (No.3) Bill 2017

**Background brief on
automatic exchange of information for tax purposes**

Purpose

This paper provides background information on the Inland Revenue (Amendment) (No.3) Bill 2017 and summarizes the views and concerns expressed by Members when issues related to the implementation of automatic exchange of financial account information in tax matters ("AEOI") in Hong Kong were discussed by relevant committees of the Legislative Council ("LegCo") since the 2014-2015 legislative session.

Background

Inland Revenue (Amendment) (No. 3) Ordinance 2016

2. For the purpose of enhancing tax transparency and combating cross-border tax evasion, the Organisation for Economic Co-operation and Development ("OECD") released in July 2014 the "Standard for Automatic Exchange of Financial Account Information in Tax Matters" ("AEOI Standard"). In September 2014, the Government indicated to the Global Forum on Transparency and Exchange of Information for Tax Purposes ("Global Forum") of OECD its support for implementing AEOI on a reciprocal basis with appropriate partners with a view to commencing the first exchanges by the end of 2018. So far, 100 jurisdictions have signed up for this global initiative.

3. The Government's policy is to conduct AEOI only with partners with which Hong Kong has signed comprehensive avoidance of double taxation agreements ("CDTAs") or tax information exchange agreements ("TIEAs") on a

bilateral basis under the exchange of information ("EOI") mechanism.¹ Under this approach, Hong Kong will make use of the bilateral CDAs or TIEAs signed as the legal basis for implementing AEOI. To enable AEOI, the Inland Revenue Department ("IRD") will have to sign a new Competent Authority Agreement ("CAA"), which sets out the modalities of transfer of information collected pursuant to the AEOI Standard, with the tax authority of the CDA/TIEA partner concerned before the exchange of the relevant information takes place.

4. To provide for the legal framework for implementing AEOI in Hong Kong, the Government amended the Inland Revenue Ordinance (Cap. 112) ("IRO") in June 2016 ("the Amendment Ordinance 2016").² The Amendment Ordinance 2016 has added a new section 50J to IRO, which empowers the Secretary for Financial Services and the Treasury to amend, among others, Schedule 17E to IRO to provide for a list of reportable jurisdictions. A reportable jurisdiction refers to a jurisdiction with which Hong Kong has entered into CDA/TIEA and CAA for the conduct of AEOI (i.e. Hong Kong's AEOI partner jurisdiction).

5. Moreover, financial institutions ("FIs") are required to conduct due diligence procedures to identify reportable accounts held by tax residents³ of confirmed AEOI partners as included in the list of reportable jurisdictions and collect the required information in respect of these reportable accounts.⁴ FIs are also required to furnish such information to IRD from a specified reporting year for onward exchange with the relevant AEOI partners.

¹ Comprehensive avoidance of double taxation agreements ("CDTAs") are tax agreements which seek to minimize incidence of double taxation between the contracting parties and provide a mechanism for the exchange of information ("EOI") between tax authorities, whereas tax information exchange agreements ("TIEAs") serve as EOI instruments without offering any taxation relief.

² The Legislative Council ("LegCo") passed the Inland Revenue (Amendment) (No. 3) Ordinance 2016 on 22 June 2016 which came into effect on 30 June 2016.

³ In general, whether or not an individual is a tax resident of a jurisdiction is determined by having regard to the person's physical presence or stay in a place (e.g. whether over 183 days within a tax year) or, in the case of a company, the place of incorporation or where the central management or control of the entity lies.

⁴ Under section 50A of the Inland Revenue Ordinance (Cap. 112), "financial institution ("FI")" means (a) a custodial institution; (b) a depository institution; (c) an investment entity; or (d) a specified insurance company. For the purpose of implementing AEOI in Hong Kong, only FIs which are resident in Hong Kong will be subject to the reporting requirements.

Progress of implementing automatic exchange of financial account information in tax matters

6. After establishing the legal framework for implementing AEOI, IRD has signed bilateral CAAs with Japan and the United Kingdom ("UK") for conducting AEOI starting from 2018. Both jurisdictions, being confirmed AEOI partners of Hong Kong, have been included in the list of reportable jurisdictions in Part 1 of Schedule 17E to IRO, so that FIs can conduct their due diligence and data collection accordingly.⁵

7. In October 2016, Hong Kong indicated that it will expand its AEOI network to cover all tax treaty partners⁶ committed to adopting AEOI, and IRD has approached them for CAA discussions. Since then, Hong Kong has signed bilateral CAAs with Belgium, Canada, Guernsey, Italy, Korea, Mexico, the Netherlands, Portugal and South Africa, bringing up the number of Hong Kong's confirmed AEOI partners to a total of 11.

Latest International Developments

8. According to the Government, the international community has been closely monitoring jurisdictions' progress in the implementation of AEOI and putting emphasis on a wide network of AEOI to ensure a level playing field. Both OECD and the European Union ("EU") have kicked off their respective exercise to draw up lists of "non-cooperative tax jurisdictions". One of the listing criteria is the progress and the network of implementing AEOI, and EU is particularly keen on receiving data with respect to 2017 and would like to get data at least for the period commencing 1 July 2017. Hong Kong needs to take timely action in response to the mounting aspirations of OECD and EU for preserving data from the second half of 2017 for exchange with other jurisdictions so as to avoid being listed as "non-cooperative tax jurisdictions", which could be subject to counter-measures including the imposition of withholding taxes.

⁵ The Inland Revenue Ordinance (Amendment of Schedule 17E) Notice 2016 was tabled before LegCo on 2 November 2016 to, among other things, add Japan and the United Kingdom in the list of reportable jurisdictions. The relevant provisions came into operation on 31 December 2016.

⁶ At present, Hong Kong has 44 tax treaty partners, including 37 CDTA partners and 7 TIEA partners. Among them, 39 have committed to adopting AEOI. The five exceptions are: Belarus, Pakistan, Thailand, the United States and Vietnam.

9. In order to expand Hong Kong's AEOI network speedily, the Government considers it necessary to amend IRO so as to mandate FIs to identify and collect information in relation to accounts held by tax residents of prospective AEOI partners,⁷ in addition to confirmed AEOI partners, of Hong Kong.

The Inland Revenue (Amendment) (No.3) Bill 2017

10. The Inland Revenue (Amendment) (No.3) Bill 2017 ("the Amendment Bill 2017") was gazetted on 24 March 2017, and received its First Reading at the LegCo meeting of 29 March 2017. The Amendment Bill 2017 aims to amend Part 1 of Schedule 17E to IRO to add 72 jurisdictions (including prospective and confirmed AEOI partners other than Japan and UK) to the list of reportable jurisdictions with 2018 as the reporting year.

11. Details of the main provisions of the Amendment Bill 2017 are set out in paragraph 14 of the LegCo Brief (File Ref: TsyB R 183/700-6/7/0(C) dated 22 March 2017), and paragraphs 6 to 9 of the Legal Service Division Report on the Amendment Bill 2017 (LC Paper No. LS51/16-17). The Amendment Bill 2017, if passed, would come into operation on 1 July 2017.

Major views and concerns expressed by Members

12. Matters relating to the implementation of the AEOI regime in Hong Kong were discussed at the meetings of the Panel on Financial Affairs on 3 November 2014, 6 July 2015 and 16 March 2017, the Bills Committee on Inland Revenue (Amendment) Bill 2016, the Finance Committee during examination of the Estimates of Expenditure 2015-2016 on 30 March 2015 and the Subcommittee on Inland Revenue Ordinance (Amendment of Schedule 17E) Notice 2016. The major views and concerns expressed by Members at these meetings are summarized in the ensuing paragraphs.

⁷ The prospective automatic exchange of financial account information in tax matters ("AEOI") partners are from the following three categories–

- (a) jurisdictions which expressed an interest to the Organisation for Economic Co-operation and Development ("OECD") in late 2016 in conducting AEOI with Hong Kong;
- (b) Hong Kong's tax treaty partners which have committed to AEOI; and
- (c) all Member States of the European Union.

Protection of taxpayers' privacy and confidentiality of information exchanged

13. Members stressed the importance to strike a proper balance between tax transparency and protection of personal data privacy in implementing AEOI. They considered it incumbent upon the Government to identify AEOI partners carefully, and prevent fishing expedition by partners and disclosure of commercial information exchanged under AEOI to enforcement authorities for non-tax purposes.

14. The Administration explained that the EOI article of CDTAs and relevant articles of TIEAs had provided for safeguards to protect taxpayers' privacy and confidentiality of information exchanged, including ensuring that the information exchanged should be foreseeably relevant with a view to avoiding fishing expedition. Given that in Hong Kong, AEOI would be implemented with CDTA and TIEA partners, the safeguards would be equally applicable to information exchanged under the AEOI regime. In addition, the AEOI Standard also provided for similar safeguards. The Model Competent Authority Agreement ("Model CAA") under the AEOI Standard provided that a competent authority might suspend exchange of information or terminate a CAA by giving notice in writing to the other competent authority if there was significant non-compliance by the latter party. In the context of Hong Kong, termination of a CAA might take effect by removal of a reportable jurisdiction from Schedule 17E to IRO through subsidiary legislation.

15. Members noted that the Amendment Bill 2017 required FIs to identify and collect information on financial accounts of 72 additional confirmed or prospective AEOI partners to be included in the list of reportable jurisdictions with effect from 1 July 2017. Hong Kong would only exchange information with a reportable jurisdiction when a CDTA/TIEA was in place together with a bilateral CAA signed with the jurisdiction on that basis for conducting AEOI. Members enquired how the privacy of personal data would be protected in implementing AEOI in particular during the period between 1 July 2017 when the collection of data commenced and the actual exchange began, as well as the application of the Personal Data (Privacy) Ordinance (Cap. 486) in this regard.

16. The Administration responded that IRD was obliged to protect personal data privacy and to ensure the confidentiality of the information collected. IRD would conduct AEOI only with partners who could meet relevant requirements on protection of privacy and confidentiality of information exchanged and ensure proper use of the data. The Administration had kept the Office of the Privacy Commissioner for Personal Data informed of the AEOI initiative and would ensure compliance with the relevant requirements in confidentiality and personal data privacy. The Administration would also seek to expand Hong

Kong's AEOI network swiftly, and consider the application of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters to Hong Kong for conducting AEOI.

Operational arrangements for automatic exchange of information with reportable jurisdictions

17. Members noted that reporting FIs should start conducting due diligence procedures and collect information from account holders who were 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. FIs should lodge the AEOI returns within five months after the calendar year to which the information related and IRD would then commence the first information exchange with the tax authorities of the confirmed AEOI partners in the following September (and September annually thereafter). Given the bulk of information involved, Members asked whether it would be feasible to spread out the deadlines for FIs to submit the AEOI returns in respect of different jurisdictions over different months of a reporting year.

18. The Administration responded that the automatic exchange of information among tax authorities in September each year was a common timeframe for all jurisdictions taking part in the AEOI initiative. To meet this timeframe, FIs would be required to submit their AEOI returns to IRD by May in the reporting year concerned. OECD would put in place a Common Transmission System for exchange of information among tax authorities. At the domestic level, IRD would put in place a secure platform, i.e. the AEOI Portal, for FIs to submit notifications and file returns on required information of reportable accounts electronically. It was envisaged that with this new electronic platform in place, the processing and exchange of data would not create too much administrative burden on IRD.

Exercising reasonable due diligence by reporting financial institutions

19. Members enquired about how reporting FIs would be taken as having exercised all reasonable due diligence to identify the tax residences of account holders. Some Members expressed concern about whether the AEOI-related due diligence requirements would create undue compliance burden on reporting FIs, and considered that the Administration should exercise a flexible and lenient approach in handling non-compliances of reporting FIs at the initial stage in implementing AEOI.

20. The Administration advised that self-certification by account holders would be an important tool for reporting FIs to fulfil their reporting and due diligence obligations, in particular to determine the tax residences of account holders. The Administration stressed that reporting FIs were not expected to carry out independent legal analyses of relevant tax laws or carry out investigation to determine the tax residences of the account holders. IRD would promulgate guidelines, which would include a sample self-certification form for reporting FIs' reference and brief them regarding the due diligence and reporting requirements.

21. In response to Members' concern that the general public might not be familiar with how to ascertain their tax residences in relation to AEOI, the Administration indicated that IRD had uploaded a set of frequently asked questions onto its website to explain the operation and requirements of AEOI, and it would update the relevant information in a timely manner.

Latest development

22. At the House Committee meeting on 7 April 2017, Members agreed to form a Bills Committee to study the Amendment Bill 2017.

Relevant papers

23. A list of relevant papers is set out in the **Appendix**.

List of relevant papers

Date	Event	Paper
3 November 2014	Meeting of the FA Panel	Administration's paper (LC Paper No. CB(1)122/14-15(03)) Background brief (LC Paper No. CB(1)122/14-15(04)) Minutes (paragraphs 38-51) (LC Paper No. CB(1)379/14-15)
30 March 2015	Special meetings of the Finance Committee to examine the Estimates of Expenditure 2015-16 (session on public finance)	Speaking note of the Secretary for Financial Services and the Treasury Report on the examination of the Estimates of Expenditure 2015-2016
6 July 2015	Meeting of the FA Panel	Administration's paper (LC Paper No. CB(1)1034/14-15(06)) Updated background brief (LC Paper No. CB(1)1034/14-15(07)) Minutes (paragraphs 54-64) (LC Paper No. CB(1)1258/14-15)
22 June 2016	The Legislative Council passed the Inland Revenue (Amendment) Bill 2016	Hansard The Bill passed Report of the Bills Committee (LC Paper No. CB(1)984/15-16)

Date	Event	Paper
2 November 2016	The Subcommittee on Inland Revenue Ordinance (Amendment of Schedule 17E) Notice 2016	Report (LC Paper No. CB(1)281/16-17)
16 March 2017	Meeting of the FA Panel	Administration's paper (LC Paper No. CB(1)660/16-17(09)) Updated background brief (LC Paper No. CB(1)660/16-17(10))