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Panel on Financial Affairs

Meeting on 16 March 2017

**Updated background brief on
automatic exchange of information for tax purposes**

Purpose

This paper provides background information on the implementation of automatic exchange of financial account information in tax matters ("AEOI") in Hong Kong, and summarizes the views and concerns expressed by Members when related issues 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").¹ The AEOI Standard requires a financial institution ("FI") to conduct due diligence procedures to identify reportable accounts held by tax

¹ Standard for Automatic Exchange of Financial Account Information in Tax Matters ("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.

residents² of reportable jurisdictions and collect the required information in respect of these reportable accounts.³ FIs are also required to report such information to the tax authority in a specified format. Upon receipt of the information from FIs, the tax authority will exchange the relevant information with the tax authorities of the AEOI partner jurisdictions on an annual basis.

3. In order to catch up with the latest international standard on AEOI, the Government indicated to the Global Forum on Transparency and Exchange of Information for Tax Purposes ("Global Forum") of OECD in September 2014 its support for implementing AEOI on a reciprocal basis with appropriate partners and amended the Inland Revenue Ordinance (Cap. 112) ("IRO") in June 2016 ("the Amendment Ordinance 2016") to provide for the legal framework for implementing AEOI in Hong Kong.⁴

4. 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.⁵ Under this approach, Hong Kong will make use of the bilateral CDTAs 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 CDTA/TIEA partner concerned before the exchange of the relevant information

² "Tax residents of reportable jurisdictions" refers to those who are liable to tax by reason of residence in the jurisdictions with which Hong Kong will conduct AEOI. 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.

³ Under section 50A of the Inland Revenue Ordinance (Cap. 112) ("IRO"), "financial institution" 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.

⁴ 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.

⁵ 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. As at November 2016, Hong Kong has signed CDTAs with 35 jurisdictions and TIEAs with seven jurisdictions.

takes place. The Amendment Ordinance 2016 has incorporated the essential requirements of the AEOI Standard, namely key provisions of CAA and due diligence requirements as laid down in the Common Reporting Standard.

5. 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 and a list of participating jurisdictions.⁶ A reportable jurisdiction refers to a jurisdiction with which Hong Kong has entered into CDTA/TIEA and CAA for the conduct of AEOI (i.e. Hong Kong's AEOI partner jurisdiction). Whereas a participating jurisdiction refers to a territory outside of Hong Kong that is committed to adopting AEOI by 2018.

6. In accordance with the AEOI Standard, when performing due diligence procedures, FIs are required to "look through" an account holder which is a professionally-managed investment entity residing in a non-participating jurisdiction, and see if any of the controlling persons of the entity is a tax resident of a reportable jurisdiction. If affirmative, the FI concerned is required to report such information to IRD for exchange with the reportable jurisdictions concerned. This "look through requirement" seeks to prevent controlling persons from "hiding" their identity behind the relevant entities residing in a non-participating jurisdiction. As the "look through requirement" will not apply if the entity is a resident in a participating jurisdiction, the extent to which FIs in Hong Kong are required to conduct "look through" checks depends on the list of participating jurisdictions. Having regard to OECD's requirements and the aim of reducing the compliance burden of FIs, the Administration had included all the 100 jurisdictions committed to adopting AEOI (excluding Hong Kong) as participating jurisdictions under Schedule 17E.⁷

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

7. On 2 November 2016, the Government tabled the Inland Revenue Ordinance (Amendment of Schedule 17E) Notice 2016 ("the Amendment

⁶ The Secretary for Financial Services and the Treasury may amend Schedule 17E to IRO by notice in the Gazette, which is subject to negative vetting by LegCo.

⁷ In setting out the list of participating jurisdictions, the Organisation for Economic Co-operation and Development allows for the following options:

- (a) jurisdictions having in place a CAA for AEOI;
- (b) all jurisdictions committed to adopting AEOI by 2018 (i.e. 100 jurisdictions excluding Hong Kong); or
- (c) jurisdictions having signed the Multilateral CAA (i.e. 87 jurisdictions as at November 2016).

Notice 2016") before LegCo for negative vetting. The relevant provisions came into operation on 31 December 2016. By way of the Amendment Notice 2016:

- (a) Japan and the United Kingdom, with which IRD has signed bilateral CAAs are included in the list of "reportable jurisdictions", and Hong Kong will conduct AEOI with these two jurisdictions from 2018; and
- (b) all the 100 jurisdictions which have committed to adopting AEOI by 2018 are included "participating jurisdictions".

8. On 23 January 2017, Hong Kong signed a CAA with Korea with a view to commencing AEOI in 2019. The Administration will later introduce relevant subsidiary legislation to include Korea in the list of reportable jurisdictions.

Major views and concerns expressed by Members

9. Matters relating to the implementation of the AEOI regime in Hong Kong were discussed at the meetings of the Panel on Financial Affairs ("FA Panel") on 3 November 2014 and 6 July 2015, 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.

Justifications for implementing automatic exchange of financial account information in tax matters

10. While some Members considered that Hong Kong should implement AEOI in order to fulfil its responsibility in international tax cooperation, some other Members queried the benefits of the initiative and expressed concern about AEOI undermining the attractiveness of Hong Kong's simple tax regime to businesses and talents.

11. The Administration advised that the vast majority of member jurisdictions of the Global Forum, including a significant number of Hong Kong's major trading partners, had already committed to implementing AEOI. From 2017 onwards, the Global Forum would conduct a peer review on member jurisdictions regarding the effectiveness of their legal frameworks for AEOI and their progress in implementing AEOI. It would 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. The Administration added that Hong Kong could benefit from implementing AEOI on a reciprocal basis as it might enable IRD to obtain more comprehensive financial information of Hong Kong taxpayers, which could facilitate its assessment and recovery of tax in default.

Approach for the inclusion of reportable jurisdictions

12. Members enquired about the criteria for identifying potential AEOI candidates (i.e. reportable jurisdictions) from Hong Kong's existing or future CDTA/TIEA partners, and the Administration's plan to include more jurisdictions as reportable jurisdictions.

13. The Administration advised that in principle, the potential AEOI candidates should be capable of meeting the AEOI Standard, and have relevant safeguards in their domestic laws for protecting data privacy and confidentiality of the information exchanged. The Administration would also take into account the bilateral trade relationship with the potential AEOI candidates, and the outcome of assessments arising from the review to be conducted by the Global Forum regarding the confidentiality and data safeguards of the jurisdictions committed to implementing AEOI. Following the passage of the Amendment Ordinance 2016, IRD had liaised with 10 jurisdictions from July to September 2016, and among them Japan and UK had signed CAAs with Hong Kong so far. The current progress was in line with the Administration's plan to adopt a pragmatic and progressive approach to meet the requirement of commencing the first automatic exchanges by 2018, whilst minimizing the compliance burden on FIs and their non-Hong Kong tax resident account holders. Going forward, the Administration would seek to expand Hong Kong's network of AEOI and commence CAA discussions with other CDTA/TIEA partners.

Protection of taxpayers' privacy and confidentiality of information exchanged

14. 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.

15. 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 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.

Operational arrangements for automatic exchange of information with reportable jurisdictions

16. 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 reportable jurisdiction in the following September (and September annually thereafter). Given the bulk of information involved and that the volume would increase when Hong Kong progressively expanded its list of reportable jurisdictions in future, 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.

17. The Administration responded that the automatic exchange of information among tax authorities in September each year was a common timeframe for all reportable jurisdictions. 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

18. 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.

19. 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.

20. 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.

Offence relating to the making of self-certification that was misleading, false or incorrect

21. Members were concerned that the imposition of criminal sanction against the offence of providing misleading, false or incorrect information in a self-certification under section 80(2E) of IRO might not be justified. They worried that account holders might be caught by the offence inadvertently as they might not be aware of their legal liabilities when providing information to reporting FIs, or might be unfamiliar with the legal concept of tax residence in jurisdictions outside Hong Kong. Members requested IRD to put in place measures to alert account holders of the need to exercise caution in making self-certification and their legal liabilities.

22. The Administration explained that, in essence, IRD could not solely rely on the self-certification to establish that a person had committed an offence, unless the two prescribed conditions under section 80(2E) of IRO (namely, the account holder, in making the self-certification, (a) made a statement that was misleading, false or incorrect in a material particular; and (b) knew, or was reckless as to whether, the statement was misleading, false or incorrect in a material particular) were both met. Moreover, the account holder had the opportunity to defend his/her position when making explanation to IRD and had the right to keep silent as well.

Latest development

23. The Administration will update members on implementation of AEOI at the FA Panel meeting on 16 March 2017.

Relevant papers

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

Council Business Division 1
Legislative Council Secretariat
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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)