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Paper for the House Committee meeting on 12 January 2018

**Report of the Bills Committee on Inland Revenue
(Amendment) (No. 5) Bill 2017**

Purpose

This paper reports on the deliberations of the Bills Committee on Inland Revenue (Amendment) (No. 5) Bill 2017 ("the Bills Committee").

Background

2. The Organisation for Economic Co-operation and Development ("OECD") has been advocating exchange of information ("EOI") for tax purposes across jurisdictions to enhance tax transparency and combat cross-border tax evasion. The automatic exchange of financial account information in tax matters ("AEOI") and combating base erosion and profit shifting ("BEPS") are the two most important initiatives in recent years.

Automatic exchange of financial account information in tax matters

3. In July 2014, OECD promulgated the Common Reporting Standard ("CRS") for implementation of AEOI. In September 2014, Hong Kong indicated 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. Up to October 2017, 102 jurisdictions have committed to this global initiative. The AEOI initiative requires financial institutions ("FIs") to identify financial accounts held by tax residents of reportable jurisdictions, and to collect the reportable information of these financial accounts for reporting to the tax authority in accordance with CRS. Individual tax authorities will exchange the collected information with their counterparts of other jurisdictions on an annual basis. To provide for the legal framework for implementing AEOI in

Hong Kong, the Government introduced amendments to the Inland Revenue Ordinance (Cap. 112) ("IRO"), which was subsequently enacted as the Inland Revenue (Amendment) (No. 3) Ordinance 2016 in June 2016.

4. OECD allows jurisdictions to conduct AEOI on either a bilateral or multilateral basis. The bilateral approach involves the signing of bilateral Competent Authority Agreements ("CAAs") for AEOI with other jurisdictions having a Comprehensive Avoidance of Double Taxation Agreement ("CDTA") or a Tax Information Exchange Agreement ("TIEA") as the basis for exchange;¹ whereas the multilateral approach involves the signing of a multilateral CAA under the Multilateral Convention on Mutual Administrative Assistance in Tax Matters ("Multilateral Convention"). The Government has been working on the conduct of AEOI on a bilateral basis with Hong Kong's CDTA or TIEA partners. As of 30 November 2017, Hong Kong has signed 38 CDTAs² and seven TIEAs³. 15 bilateral CAAs⁴ have been signed for AEOI since the enactment of the Inland Revenue (Amendment) (No. 3) Ordinance 2016.

5. 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 and non-compliant jurisdictions on tax transparency. Among the listing criteria are the progress and the network of implementing AEOI as well as participation in the Multilateral Convention. According to the Government, Hong Kong faces constraints in the negotiations of bilateral CAAs because such discussion with individual jurisdictions take

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 38 CDTAs signed with Belgium, Thailand, Mainland of China, Luxembourg, Vietnam, Brunei, the Netherlands, Indonesia, Hungary, Kuwait, Austria, the United Kingdom, Ireland, Liechtenstein, France, Japan, New Zealand, Portugal, Spain, the Czech Republic, Switzerland, Malta, Jersey, Malaysia, Mexico, Canada, Italy, Guernsey, Qatar, Korea, South Africa, the United Arab Emirates, Romania, Russia, Latvia, Belarus, Pakistan and Saudi Arabia.

³ Seven TIEAs signed with the United States, Norway, Denmark, Sweden, Iceland, Greenland and the Faroes.

⁴ 15 bilateral Competent Authority Agreements signed with Japan, the United Kingdom, Korea, Belgium, Canada, Guernsey, Mexico, the Netherlands, Italy, Portugal, South Africa, Ireland, Indonesia, New Zealand and Switzerland.

time, and in many cases, Hong Kong's bilateral tax treaties (i.e. CDTAs or TIEAs) will need to be amended to allow for AEOI.

Base erosion and profit shifting

6. In October 2015, OECD and the Group of Twenty released a package of 15 actions to combat BEPS. BEPS refers to tax planning strategies of multinational enterprises that exploit the gaps and mismatches in tax rules among economies to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid. Hong Kong indicated to OECD in June 2016 its commitment to implementing the BEPS package. To meet the four minimum standards⁵ in the BEPS package, Hong Kong needs to take forward automatic exchange of Country-by-Country reports for the assessment of transfer pricing risks of multinational enterprises and spontaneous EOI on tax rulings.⁶

7. According to the Government, whilst a bilateral approach could be adopted for implementing the initiatives under BEPS, it has become increasingly impractical given the continued expansion in the scope of tax information exchanges in the international community. A more practical approach is for jurisdictions to adopt the Multilateral Convention as a basis to implement the BEPS initiatives.

Multilateral Convention on Mutual Administrative Assistance in Tax Matters

8. The Multilateral Convention is jointly developed by OECD and the Council of Europe to provide for all possible forms of administrative cooperation between state parties in the assessment and collection of taxes, in particular with a view to combating tax avoidance and evasion. The Multilateral Convention provides a basis for jurisdictions to conduct AEOI and implement the BEPS initiatives on a multilateral basis by signing respective multilateral CAAs under the Convention. The Multilateral Convention has been open for signature by states since 1 June 2011. According to the Government, as at 15 December 2017, 116 jurisdictions participated in the Multilateral Convention, including 15 jurisdictions covered by territorial extension.

⁵ The four minimum standards are: countering harmful tax practices (Action 5), preventing treaty abuse (Action 6), imposing Country-by-Country reporting requirement (Action 13) and improving cross-border dispute resolution mechanism (Action 14).

⁶ According to the Government, it will introduce a bill to amend the Inland Revenue Ordinance (Cap. 112) to implement the minimum standards under the base erosion and profit shifting package.

9. At present, Hong Kong is not a participant of the Multilateral Convention. According to the Government, all 102 AEOI-committed jurisdictions have either joined or indicated to join the Multilateral Convention. Indeed, participation in the Multilateral Convention is a key element when OECD and EU consider whether a tax jurisdiction is "cooperative" or "compliant" in respect of tax transparency matters. In view of the continued expansion in the scope of tax information exchanges in the international community, the Government considers that the bilateral approach which Hong Kong has adopted is no longer effective nor efficient in implementing the AEOI and BEPS initiatives, and it is necessary to seek the application of the Multilateral Convention to Hong Kong. Upon the request of Hong Kong, the Central People's Government ("CPG") gave in-principle agreement in May 2017 to extend the application of the Multilateral Convention to Hong Kong.

The Bill

10. The Government published the Inland Revenue (Amendment) (No. 5) Bill 2017 ("the Bill") in the Gazette on 6 October 2017 which received its First Reading at the Legislative Council ("LegCo") meeting of 18 October 2017. The Bill seeks to empower the Chief Executive in Council to give effect to the Multilateral Convention and other agreements on international tax cooperation that apply to Hong Kong, and to amend IRO to align relevant provisions in IRO for AEOI with CRS.

11. The main provisions of the Bill are as follows:

- (a) Clause 4 – to amend section 49 of IRO to expand the scope of arrangements under section 49(1A) that may be specified by the Chief Executive in Council in an order (made under that section) to include arrangements that are made with more than one government and arrangements that are made by the CPG and applied to Hong Kong, and for the purpose of implementing an initiative of international tax cooperation, in addition to affording relief from double taxation and EOI in relation to tax; and
- (b) Clauses 5 to 11 – to amend sections 50A, 50B and 50C of, and Schedules 17C and 17D to IRO to align the provisions concerned with CRS in the implementation of AEOI.

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

The Bills Committee

13. At the House Committee meeting on 20 October 2017, 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 Hon WONG Ting-kwong, the Bills Committee has held two meetings to discuss the Bill with the Government. The Bills Committee has also received a written submission from The Hong Kong Association of Banks ("HKAB").

Deliberations of the Bills Committee

14. The Bills Committee supports the Bill in general. The deliberations of the Bills Committee are set out in the ensuing paragraphs.

Amendments to align the provisions on automatic exchange of financial account information on tax matters with the Common Reporting Standard

15. The Bills Committee has sought details on the proposed amendments in the Bill which aim to align the relevant provisions in IRO for the implementation of AEOI with CRS promulgated by OECD.

16. The Government has explained that the proposed amendments (in Clauses 5 to 11 of the Bill) are to ensure the effective implementation of CRS in Hong Kong and to remove inconsistencies identified either by the Government or by OECD during recent examination of IRO. The proposed amendments in the Bill and the corresponding provisions in CRS are summarized in **Appendix II**. The proposed amendments include:

- (a) clarifying the definitions of annuity contract, cash value, depository account, financial account, pre-existing account and specified insurance company, and adding a definition of insurance company;
- (b) aligning the threshold of defining controlling person with CRS requirements (i.e. consistent with the recommendations of Financial Action Task Force adopted in 2012);
- (c) aligning the record keeping requirements with CRS;
- (d) clarifying the criteria for qualified credit card issuer and exempt collective investment vehicle under non-reporting financial institutions; and

- (e) clarifying the due diligence procedures for dormant account and determining residence of controlling persons of passive NFE (NFE refers to an entity that is not an FI).

17. The Bills Committee has noted the views of HKAB on the impact of the proposed amendments relating to the AEOI provisions in IRO on the operation of FIs. For instance, HKAB has pointed out that the proposed amendment to the specified percentage for determination of controlling person under section 50A(6) of IRO from "not less than 25%" to "more than 25%" will narrow the scope of controlling person. FIs will need to examine their existing lists of "controlling persons" to see if they meet the new definition. HKAB has also pointed out that the amendments in section 7 under Part 3 of Schedule 17C to IRO relating to the definition of dormant account may tighten the definition. As a result, FIs will need to revisit customer dormant accounts with a view to identifying those no longer meeting the amended definition. As FIs have already made preparations for the first report in relation to the implementation of AEOI that is due for May 2018 (covering data in 2017), HKAB is concerned that FIs may need to revisit their revised procedures made for the first report and thus creating a compliance burden on them.

18. The Government has reiterated that the amendments concerning AEOI under the Bill aim to align some current provisions under IRO with CRS without making substantial changes to the due diligence requirements. The Government understands that reporting FIs will take time to fine-tune their systems and mode of operation in order to implement the refinements. Assuming that the Bill will be enacted within 2018, the arrangements provided under the Bill at present are as follows:

- (a) For the first report due for May 2018 (covering data in 2017), reporting FIs are not required to follow the refinements as proposed in the Bill.
- (b) For the second report due for May 2019 (covering data in 2018) –
 - (i) from 1 January 2018 to the date that the Bill is enacted, the current statutory provisions governing the identification of reportable accounts under the IRO ("Existing Provisions") will continue to apply. The new provisions to be aligned with CRS contemplated under the Bill ("Refined Provisions") will not kick in; and
 - (ii) from the date that the Bill is enacted, the Refined Provisions will apply.

19. Taking into account the concerns expressed by HKAB and in order to minimize the compliance burden on FIs, the Government has proposed that the Existing Provisions will continue to apply to the second report due for May 2019 (covering data in 2018). In other words, the Refined Provisions will only start to apply on 1 January 2019 for the purpose of the third report due for May 2020 (covering data in 2019). To achieve this purpose, the Government will move Committee Stage amendments ("CSAs") to specify 1 January 2019 as the commencement date for Clauses 5 to 11 of the Bill (concerning the Refined Provisions). The other Clauses (for expanding the scope of section 49 of IRO) will come into operation on the day on which the Bill is published in the Gazette as an Ordinance. The Bills Committee supports the proposed CSAs which, according to the Government will allow lead time for reporting FIs to fine-tune their systems and mode of operation for the changes to be brought about by the Bill.

20. The Bills Committee further notes that the Government has taken on board HKAB's suggestions for elaborating some terms and clarifying operational issues in the Inland Revenue Department's ("IRD") guidelines to be issued after the passage of the Bill, including the meanings of an "enforcer of the trust" and "ultimate control over the entity" in the amended definition of "controlling person" (proposed amendments to section 50A(6) of IRO), as well as operational issues relating to the amended definitions of "exempt collective investment vehicle" and "dormant account" (proposed amendments to section 9 in Part 2 and section 7 in Part 3 of Schedule 17C to IRO respectively) and the determination of residence of controlling person of a passive NFE (proposed amendments to section 6 in Part 6 of Schedule 17D to IRO).

Procedures for applying the Multilateral Convention on Mutual Administrative Assistance in Tax Matters to Hong Kong and the provisions to be applied to Hong Kong

21. The Bills Committee has enquired about the procedures for applying the Multilateral Convention to Hong Kong, and the provisions in the Multilateral Convention which the Government intends to apply to Hong Kong.

22. The Government has explained that the Multilateral Convention is only open for signature by state parties and upon the request of Hong Kong, the CPG has given in-principle agreement to extend the application of the Multilateral Convention to Hong Kong. It is the Government's policy that Hong Kong will take forward the mandatory provisions of the Multilateral Convention while making suitable reservations/declarations for the optional provisions so that such provisions will not apply or will only partially apply to Hong Kong. Upon passage of the Bill, the Government will seek the CPG's assistance in depositing a declaration to OECD for territorial application of the Multilateral Convention to Hong Kong, together with the reservations/declarations

applicable to Hong Kong. After that, the Government will recommend the Chief Executive in Council to make an order under section 49(1A) of IRO (as amended by the Bill) to declare that the Multilateral Convention shall have effect in Hong Kong. The order is subject to the negative vetting procedure of LegCo. If it is necessary for Hong Kong to take forward the optional provisions of the Multilateral Convention in future, the Government will seek the CPG's assistance to update the reservations/declarations deposited with OECD. It will also be necessary to effect the relevant changes by way of an order under section 49(1A) of IRO (as amended by the Bill) which will also be subject to the negative vetting procedure of LegCo. An analysis and assessment by the Government of the major provisions (i.e. both mandatory and optional provisions) of the Multilateral Convention is set out in **Appendix III**.

23. The Bills Committee has sought clarification as to whether Hong Kong will take forward the provisions of the Multilateral Convention on simultaneous tax examinations and tax examinations abroad (i.e. Articles 8 and 9 of the Multilateral Convention). Members have noted that while these two provisions are mandatory, it will be up to a jurisdiction to decide whether to participate in a simultaneous tax examination and to make a declaration not to accept requests for participating in tax examinations abroad as a general rule.

24. The Government has advised that under Article 8 of the Multilateral Convention, two or more parties to the Multilateral Convention may enter into an arrangement under which the parties, each in its own territory, examine the tax affairs of persons in which they have a common or related interest, with a view to exchanging any relevant information which they so obtain. Article 9 of the Multilateral Convention states that at the request of the requesting party, the requested party may allow representatives of the requesting party to be present at the appropriate part of a tax examination carried out in the jurisdiction of the requested party. Given that Hong Kong has been operating a territorial tax regime, it appears unlikely that Hong Kong would need to ascertain a taxpayer's liability by conducting tax examinations with other jurisdictions, whether in Hong Kong or in other jurisdictions. Therefore it is the Government's policy that Hong Kong, as a general rule, will neither participate in any simultaneous tax examinations nor accept requests for tax examinations abroad from other jurisdictions.

Impact on Comprehensive Avoidance of Double Taxation Agreements and Tax Information Exchange Agreements entered by Hong Kong with other jurisdictions

25. Noting that the jurisdictions with which Hong Kong has signed CDTAs/TIEAs may have also participated in the Multilateral Convention, the Bills Committee has enquired about:

- (a) how the Government will determine whether to use the Multilateral Convention, the respective CDTAs or TIEAs for EOI with the relevant jurisdictions;
- (b) follow-up actions the Government will take if conflicting provisions are subsequently identified between the Multilateral Convention and the respective CDTAs/TIEAs signed with the jurisdictions; and
- (c) whether the Government will continue to sign CDTAs with other jurisdictions after joining the Multilateral Convention.

26. The Government has advised that the Multilateral Convention, CDTAs, or TIEAs are different platforms to facilitate EOI on tax matters. As of 30 November 2017, Hong Kong has signed 38 CDTAs and seven TIEAs with other jurisdictions. IRD will continue to use CDTAs/TIEAs as a legal basis for the exchange of tax information with Hong Kong's CDTA/TIEA partners where appropriate. In general, the Multilateral Convention will be used as the instrument for EOI if the jurisdiction concerned is a party to the Multilateral Convention but not a CDTA/TIEA partner of Hong Kong. A jurisdiction when making an EOI request must identify the basis of the request (i.e. whether it is made in accordance with the Multilateral Convention, a CDTA or TIEA) and state the information requested. The Government will consider the request in the light of the basis upon which the request claimed to be made and with references to the relevant laws of Hong Kong. These principles are also applicable to Hong Kong when it is the requesting party. The Government will continue to expand Hong Kong's CDTA network so as to minimize the incidence of double taxation between Hong Kong and other jurisdictions. As regards whether there would be conflicting provisions among a CDTA, a TIEA or the Multilateral Convention, the Government has advised that OECD has taken the bilateral modules of EOI and CDTAs into account when it designed the Multilateral Convention and the Government has not identified any conflicting provisions among the Multilateral Convention, CDTAs and TIEAs signed by Hong Kong in general.

Exchange of information under the Multilateral Convention on Mutual Administrative Assistance in Tax Matters to Hong Kong

27. The Bills Committee has enquired about the scope of information to be exchanged under the Multilateral Convention and if there is any difference from the information exchanged under a CDTA or a TIEA, the measures to protect the confidentiality of information exchanged under the Multilateral Convention in particular if such information involved personal data.

28. The Government has responded that in general, the scope of information to be exchanged, be it conducted on a bilateral basis under a CDTA or TIEA or on a multilateral basis under the Multilateral Convention, is the same. As a matter of policy, Hong Kong would participate in three forms of information exchange, namely, EOI on request (Article 5), automatic EOI (Article 6) and spontaneous EOI (Article 7) on tax rulings under the Multilateral Convention. The types of information provided or exchanged under Articles 5 to 7 may be different.

29. The Government has further explained that EOI on request refers to a situation in which a party (i.e. requesting party) seeks particular tax information from another party (i.e. requested party) related to a particular case. For example, the requesting party may ask for information from the requested party to verify the information supplied by a taxpayer about his income from, or assets in, the requested party. Information involved in automatic exchange typically entails specified information comprising many individual cases of the same category, such as information under AEOI and country-by-country reports under Action 13 of the BEPS package, in which parties would exchange the specified information at regular intervals with prior agreement. Information is exchanged spontaneously when the supplying party, having obtained information which it believes will be of interest to the receiving party, passes on the information without the receiving party having asked for it. In this regard, Hong Kong is prepared to ride on the Multilateral Convention to undertake spontaneous EOI on six specific types of tax rulings as required by Action 5 of the BEPS package. They are the "minimum standards" required by OECD under the BEPS package.

30. As regards confidentiality and data protection safeguards, the Government has stressed that the Bill does not alter the high level of privacy and confidentiality safeguards currently applicable to the handling of tax information (including personal data) under IRO. The same safeguards will apply to the Multilateral Convention as follows:

- (a) the information exchanged should be foreseeably relevant for the administration or enforcement of the receiving party's domestic laws relating to the taxes covered. In other words, there will be no "fishing expeditions" (Article 4(1));
- (b) the information received should be treated as secret by the receiving party (Article 22(1));
- (c) the information exchanged should not be disclosed to a third party without prior authorization of the supplying party (Article 22(4));

- (d) there is no obligation to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process (Article 21(2)(d));
- (e) the use of information exchanged for other purposes (i.e. non-tax related) would only be allowed if such use is allowed under the laws of both of the supplying and receiving parties and the competent authority of the supplying party authorizes such use (Article 22(4)); and
- (f) information will only be disclosed to the authorities concerned with the assessment, collection or recovery of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, taxes, or their oversight bodies (Article 22(2)).

31. The Government has supplemented that in considering whether to exchange information pursuant to the Multilateral Convention with a particular jurisdiction, the Government will also evaluate whether the receiving party is able to meet with the data protection obligations under the Multilateral Convention. These considerations include whether the receiving party has put in place sufficient safeguards to ensure data protection as required under the laws of Hong Kong (including the Personal Data (Privacy) Ordinance (Cap. 486)). If the receiving party is unable to meet the required standard, depending on the circumstances, Hong Kong may decline to provide information to the receiving party or enter into an arrangement with the receiving party whereby the receiving party agrees to comply with the data protection requirements of Hong Kong before proceeding with the EOI. Where the receiving party does not comply with its obligations regarding data protection under the Multilateral Convention or the data protection arrangement with Hong Kong, the Government may suspend EOI with the receiving party under the Multilateral Convention.

Committee stage amendments to be moved by the Government

32. To address the views raised by HKAB about the operational impact on FIs arising from the amendments in the Bill relating to the AEOI provisions for alignment with CRS, the Government has proposed CSAs to the Bill in order to minimize the compliance burden on FIs. The details are explained in paragraph 19 above. The Bills Committee supports the CSAs to be moved by the Government, and will not propose CSAs to the Bill.

33. The draft CSAs to be moved by the Government are in **Appendix IV**.

Resumption of Second Reading debate on the Bill

34. The Bills Committee has no objection to the resumption of the Second Reading debate on the Bill at the LegCo meeting of 24 January 2018.

Advise Sought

35. Members are invited to note the deliberations of the Bills Committee.

Council Business Division 1
Legislative Council Secretariat
11 January 2018

Bills Committee on Inland Revenue (Amendment) (No. 5) Bill 2017

Membership list*

| | |
|-----------------------|--|
| Chairman | Hon WONG Ting-kwong, GBS, JP |
| Members | Hon James TO Kun-sun Prof Hon Joseph LEE Kok-long, SBS, JP Hon Frankie YICK Chi-ming, SBS, JP Hon WU Chi-wai, MH Hon Charles Peter MOK, JP Hon Kenneth LEUNG Hon KWOK Wai-keung, JP Hon Dennis KWOK Wing-hang Ir Dr Hon LO Wai-kwok, SBS, MH, JP Hon Alvin YEUNG Dr Hon Junius HO Kwan-yiu, JP Hon Holden CHOW Ho-ding Hon SHIU Ka-fai Hon YUNG Hoi-yan Dr Hon Pierre CHAN Hon CHAN Chun-ying Hon CHEUNG Kwok-kwan, JP (Total : 18 members) |
| Clerk | Ms Connie SZETO |
| Legal Advisers | Miss Evelyn LEE |

*Change in membership is shown in Annex to Appendix I.

Annex to Appendix I

Bills Committee on Inland Revenue (Amendment) (No. 5) Bill 2017

Change in membership

| Member | Relevant date |
|------------------|------------------------|
| Hon SHIU Ka-chun | Up to 16 November 2017 |

**Proposed Changes in Clauses 5 to 11 of the Inland Revenue (Amendment) (No. 5) Bill 2017 (“the Bill”)
and Corresponding Provisions in the Common Reporting Standard (“CRS”)**

| Clause in the Bill | Reference in Inland Revenue Ordinance | Provision in CRS | Reasons for Change |
|--------------------|---|---|---|
| 5(1) | Section 50A(1) Interpretation – annuity contract | Subparagraph C(6), Section VIII (p. 51) | To clarify that <i>annuity contract</i> also includes a contract— (i) that is considered to be an annuity contract in accordance with the law, regulation or practice of the jurisdiction in which the contract was issued; and (ii) under which its issuer agrees to make payments for a term of years (see proposed paragraph (b)). |
| 5(2) | Section 50A(1) Interpretation – cash value | Subparagraph C(8), Section VIII (p. 52) | To clarify that the <i>cash value</i> could be determined by either the amount that the policyholder can borrow under, <i>or with regard to</i> , the contract. |
| 5(3) | Section 50A(1) Interpretation – depository account | Subparagraph A(5) and C(2), Section VIII (p. 44 and 51) | To clarify that accounts maintained by authorised institutions (defined by section 2(1) of the Banking Ordinance (Cap. 155)) also fall within the meaning of <i>depository account</i> . |
| 5(4) | Section 50A(1) Interpretation – financial account | Subparagraph C(1)(b), Section VIII (p. 50) | To clarify that any equity interest or debt interest in an advising manager are <i>financial accounts</i> if the class of such interests was established with the purpose of avoiding reporting under section 50F(1) and (2) of the Inland Revenue Ordinance (“IRO”). |
| 5(5) | Section 50A(1) Interpretation – pre-existing account | | By adding the reference to “its related entities within Hong Kong” to align the wording of paragraph (b)(ii)(A) with paragraph (b)(i) of the existing definition of <i>pre-existing account</i> . |

| Clause in the Bill | Reference in Inland Revenue Ordinance | Provision in CRS | Reasons for Change |
|--------------------|---|---|--|
| 5(6) & 5(7) | <p>Section 50A(1)</p> <p>Interpretation – specified insurance company</p> <p>New definition of insurance company</p> | <p>Paragraphs 26 and 27, Commentary on Section VIII (p. 165)</p> | <p>To clarify that only insurance company that issues, or is obliged to make payments with respect to a cash value insurance contract or an annuity contract, would fall within the scope of <i>specified insurance company</i>.</p> <p>The entities in paragraphs (a), (b) and (c) are moved to the new definition of <i>insurance company</i>. Insurance companies are only qualified as specified insurance companies if they issue, or are obliged to make payments with respect to cash value insurance contracts or annuity contracts.</p> |
| 5(8) – 5(15) | <p>Section 50A(6)</p> <p>Interpretation regarding the exercise of control in the definition of “controlling person”</p> | <p>Subparagraph D(6), Section VIII (p. 57); Paragraphs 132-137, Commentary on Section VIII (p. 198-199)</p> | <p>To include the determinant of “senior managing official” in identifying a controlling person, which is in line with the Financial Action Task Force (“FATF”) recommendation on determining beneficial ownership.</p> <p>Also to align the relevant provisions in the IRO with the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615) to facilitate compliance by financial institutions.</p> <p>For example, the threshold for determining control is currently by reference to “not less than” the specified percentage of the issued share capital[or voting rights][or capital or profit] of an entity. The threshold is proposed to be changed to “more than” the relevant specified percentage.</p> <p>It is worth noting that having reviewed the latest FATF requirement and the prevailing practice of other jurisdictions, the Government proposes relaxing the threshold of defining beneficial ownership from the current “not less than 10%” to “more than 25%” in the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) (Amendment) Bill 2017, which is currently under the scrutiny of the Legislative Council.</p> |

| Clause in the Bill | Reference in Inland Revenue Ordinance | Provision in CRS | Reasons for Change |
|--------------------|---|---------------------------------------|---|
| 5(16) | Section 50A(12) Interpretation of the term “advising manager” | | Consequential amendment is made following the amendment to paragraph (d) of the definition of <i>financial account</i> (see clause 5(4) of the Bill). |
| 6 | Section 50B Due diligence obligations on reporting financial institutions | Subparagraph A(2), Section IX (p. 61) | The CRS requires that both evidence relied on, and any record of the steps taken in due diligence are kept, but not either one. |
| 7 | Section 50C Obligations of reporting financial institutions to furnish returns | | Improving the clarity of the scope of information that could be decided by the Commissioner of Inland Revenue. Section 50C(2) of the IRO provides that an assessor’s notice may request for information in relation to reportable accounts maintained by financial institutions during the “specified information period”. The proposed section 50C(2A) further clarifies the meaning of specified information period. |

| Clause in the Bill | Reference in Inland Revenue Ordinance | Provision in CRS | Reasons for Change |
|--------------------|--|---|--|
| 8 | <p>Section 8 Qualified credit card issuer</p> <p>Part 2 Non-reporting Financial Institutions</p> <p>Schedule 17C</p> | <p>Subparagraph B(8)(b), Section VIII (p. 49)</p> | <p>The CRS stipulates that the rule in determining the scope of overpayment (existing section 8(2) of Part 2, Schedule 17C to the IRO) apply to both cases in the existing section 8(1)(b)(i) and (ii) of Part 2, Schedule 17C to the IRO.</p> |
| 9 | <p>Section 9 Exempt collective investment vehicle</p> <p>Part 2 Non-reporting Financial Institutions</p> <p>Schedule 17C</p> | <p>Subparagraph B(9), Section VIII (p. 49); Paragraph 52, Commentary on section VIII (p. 173)</p> | <p>To clarify that for a collective investment vehicle (“CIV”) to fall within the description of non-reporting financial institutions, all of the interests in such CIV should be held by individuals or entities that are not reportable persons. If the interests are held by or through a passive NFE, and one of the controlling persons of such passive NFE is reportable person, then the CIV concerned would not be regarded as an exempt CIV.</p> <p>The current formulation in the IRO could not exempt a CIV where its interests are held by entities (other than passive NFEs) that are not reportable persons.</p> |

| Clause in the Bill | Reference in Inland Revenue Ordinance | Provision in CRS | Reasons for Change |
|--------------------|--|--|--|
| 10 | Section 7 Dormant account Part 3 Excluded Accounts Schedule 17C | Paragraph 9, Commentary on section III (p. 112) | The CRS requires that all the conditions (but not either one of) in existing sections 7(a), 7(b) and 7(d) of Part 2, Schedule 17C to the IRO to be met in order to render an account dormant and hence excluded from reporting. An additional situation is now included in clause 10(4) of the Bill to elaborate what may also constitute a dormant account in accordance with the CRS (see the proposed section 7(2)). |
| 11 | Section 6 Determining residence of controlling persons of passive NFE Part 6 Due Diligence Requirements for New Entity Accounts Schedule 17D | Paragraph 20, Commentary on section VI (p. 148) | To align with the requirement of the CRS Commentary that a reporting financial institution may rely only on a self-certification (with no other reliance) from either an account holder or controlling person for the purpose of determining whether the controlling person is a reportable person for new entity accounts. |

**Analysis and assessment of the major provisions of
the Multilateral Convention**

| Provision | Nature | Analysis and Assessment |
|--|-----------|--|
| (a) Types of taxes covered (Article 2) | - | <p>The minimum types of taxes covered by the Multilateral Convention include taxes on income or profits, taxes on capital gains which are imposed separately from the tax on income or profits, and taxes on net wealth.</p> <p>While the Multilateral Convention may also cover other types of taxes, we propose that Hong Kong would only provide assistance to the minimum types of taxes above.</p> |
| (b) Exchange of information on request (Article 5) | Mandatory | <p>Hong Kong has been handling exchange of information requests from our CDTA/TIEA partners and, in accordance with the OECD's standard. The scope of information to be provided under CDTA/TIEA or under the Multilateral Convention is the same.</p> <p>We propose that this mandatory provision should apply to Hong Kong.</p> |
| (c) Automatic exchange of information (Article 6) | Mandatory | <p>Hong Kong has already put in place the legal framework for implementing AEOI, and is prepared to expand AEOI network through the Multilateral Convention. Hong Kong can also rely on this provision to take forward automatic exchange of CbC reports which is a minimum standard under the BEPS package.</p> <p>We propose that this mandatory provision should apply to Hong Kong.</p> |

| Provision | Nature | Analysis and Assessment |
|--|---|--|
| (d) Spontaneous exchange of information (Article 7) | Mandatory | <p>While Hong Kong has not conducted spontaneous exchange of information with our CDTA/TIEA partners so far, Hong Kong has undertaken to exchange information on six types of tax rulings, under the minimum standard of the BEPS package, on a spontaneous basis. Hong Kong can rely on this provision to take forward such exchange.</p> <p>We propose that this mandatory provision should apply to Hong Kong.</p> |
| (e) Simultaneous tax examinations (Article 8) | Mandatory, but it will be up to a party to decide whether to participate in a particular examination | <p>Simultaneous tax examination refers to an arrangement between two or more jurisdictions, each in its own territory, to examine tax affairs of persons in which they have a common or related interest, with a view to exchanging any relevant information which they so obtain.</p> <p>We propose that Hong Kong, as a general rule, will not participate in any simultaneous tax examinations.</p> |
| (f) Tax examinations abroad (Article 9) | Mandatory provision, but a party can make a declaration not to accept such requests as a general rule | <p>Tax examinations abroad refers to an arrangement which a jurisdiction may allow the representative from another jurisdiction, upon the latter's request, to be present at the appropriate part of a tax examination in the former's territory.</p> <p>We propose to declare under the Multilateral Convention that, as a general rule, Hong Kong will not accept such requests.</p> |
| (g) Assistance in recovery of taxes (Articles 11-16) | Optional | <p>These provisions refer to the assistance which a jurisdiction provides for recovery of taxes that are charged by another jurisdiction.</p> <p>We propose that Hong Kong will not provide such assistance.</p> |
| (h) Service of documents (Article 17) | Optional | <p>This provision refers to the assistance which a jurisdiction provides for service of documents, including those relating to judicial decisions, which relate to a tax covered by the Multilateral Convention at the request of another jurisdiction.</p> <p>We propose that Hong Kong will not provide such assistance.</p> |

Provisions not listed in the above table are technical and operational in nature, e.g. definitions, how to deal with conflicting information received and language of transmission.

Inland Revenue (Amendment) (No. 5) Bill 2017

Committee Stage

Amendments to be moved by the Secretary for Financial Services and the Treasury

| <u>Clause</u> | <u>Amendment Proposed</u> |
|---------------|---|
| 1 | In the heading, by adding “ and commencement ” after “ Short title ”. |
| 1 | By renumbering the clause as clause 1(1). |
| 1 | By adding— “(2) Subject to subsection (3), this Ordinance comes into operation on the day on which it is published in the Gazette. (3) Sections 5, 6, 7, 8, 9, 10 and 11 come into operation on 1 January 2019.”. |