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Background brief on application of Multilateral Convention on Mutual Administrative Assistance in Tax Matters in Hong Kong

Purpose

This paper provides background information on the application of Multilateral Convention on Mutual Administrative Assistance in Tax Matters ("Multilateral Convention") to Hong Kong and summarizes the major views and concerns expressed by members of the Panel on Financial Affairs ("FA Panel") when related matters were discussed in the 2016-2017 legislative session.

Background

Automatic exchange of financial account information in tax matters

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 Common Reporting Standard ("CRS") for implementation of automatic exchange of financial account information in tax matters ("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. So far, 102 jurisdictions have committed to 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 mechanism.¹ Under this approach, Hong Kong will make use of the bilateral CDTAs or TIEAs signed as the legal basis for implementing AEOI.² 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 takes place.

4. 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 were subsequently enacted as the Inland Revenue (Amendment) (No. 3) Ordinance 2016 in June 2016.³ The Amendment Ordinance has added a new section 50J to IRO empowering 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 CDTA/TIEA and CAA for the conduct of AEOI (i.e. Hong Kong's AEOI partner). Financial institutions ("FIs") are required to conduct due diligence procedures to identify reportable accounts held by tax residents of confirmed AEOI partners as included in the list of reportable jurisdictions and collect the required information in respect of these reportable accounts. FIs are also required to furnish such information to IRD from a specific reporting year for onward exchange with the relevant AEOI partners. As of 31 August 2017,

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 CDTAs and TIEAs signed between Hong Kong and other jurisdictions are giving effect in Hong Kong by orders made under section 49(1A) of the Inland Revenue Ordinance (Cap. 112). Such orders are subject to the negative vetting procedure of the Legislative Council ("LegCo").

³ The Inland Revenue (Amendment) Bill 2016 was introduced into LegCo in January 2016. The Bill was passed by LegCo on 22 June 2016 which came into effect on 30 June 2016.

Hong Kong has signed 38 CDTAs,⁴ seven TIEAs,⁵ and 14 bilateral CAAs for AEOI.⁶

Inland Revenue (Amendment) (No.2) Ordinance 2017

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. The criteria adopted by OECD and EU in this respect are set out in **Appendix I**. Among the listing criteria are the progress and the network of implementing AEOI as well as participation in the Multilateral Convention.

6. Hong Kong faces constraints in the negotiations of bilateral CAA because such discussions with individual jurisdictions take 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. Moreover, FIs are mandated to identify and collect information in relation to accounts held by tax residents of confirmed AEOI partners as included in the list of reportable jurisdictions only. To overcome the above challenges, the Government introduced amendments to IRO, which were subsequently enacted as the Inland Revenue (Amendment) (No.2) Ordinance 2017 in June 2017,⁷ to mandate FIs to identify and collect information in relation to accounts held by tax residents of prospective AEOI partners, in addition to confirmed AEOI partners, of Hong Kong. The Amendment Ordinance 2017 has amended Part 1 of Schedule 17E to IRO to expand the list of reportable jurisdictions to cover 75 jurisdictions, comprising

⁴ 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.

⁵ Seven TIEAs signed with the United States, Norway, Denmark, Sweden, Iceland, Greenland and the Faroes.

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

⁷ The Inland Revenue (Amendment) (No. 3) Bill 2017 was introduced into LegCo in March 2017. The Bill was passed by LegCo on 22 June 2017 which came into effect on 1 July 2017.

13 confirmed AEOI partners and 62 prospective⁸ AEOI partners.

Base erosion and profit shifting

7. In October 2015, OECD and the Group of Twenty released a package of 15 actions to combat base erosion and profit shifting ("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 standards⁹ 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 exchange of information on tax rulings.

8. According to the Government, whilst a bilateral approach could be adopted for implementing these 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

9. 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 initiatives to combat BEPS on a multilateral basis by signing a multilateral CAA under the Convention. The Multilateral Convention has been

⁸ The 62 prospective automatic exchange of financial account information in tax matters ("AEOI") partners are from the following three categories:

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

⁹ 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).

opened for signature by states since 1 June 2011. According to the Government, as at September 2017, 113 jurisdictions participated in the Multilateral Convention, including 15 jurisdictions covered by territorial extension.

10. At present, Hong Kong is not covered by 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 "non-cooperative" or "non-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 or 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 Inland Revenue (Amendment) (No.5) Bill 2017

11. At present, section 49(1A) of IRO empowers the Chief Executive in Council ("CE-in-C") to declare, by order, that arrangements specified in that order have been made with the government of any territory outside Hong Kong shall have effect if, among other things, such arrangements are made for the purposes of exchanging tax information. This is also the basis on which the bilateral CDTAs and TIEAs previously signed by Hong Kong with other territories are given effect. However, the relevant power under the current IRO covers neither multilateral tax agreements nor international tax cooperation arrangements for purposes other than affording relief from double taxation and exchange of information in relation to tax.

12. The Government has introduced the Inland Revenue (Amendment) (No.5) Bill 2017 ("the Amendment (No.5) Bill 2017") to amend IRO to empower CE-in-C to give effect to the Multilateral Convention and any other tax agreements that apply to Hong Kong. The Amendment (No.5) Bill 2017 was gazetted on 6 October 2017, and received its First Reading at the Legislative Council meeting of 18 October 2017. The Bill is under the scrutiny by a Bills Committee formed at the House Committee meeting on 20 October 2017.

13. According to the Government, upon enactment of the Amendment (No.5) Bill 2017, it will seek the assistance of CPG to deposit a declaration for territorial application of the Multilateral Convention to OECD, together with the

reservations and declarations applicable to Hong Kong.¹⁰ The Multilateral Convention will start to have effect in Hong Kong on the first day of the month following the expiration of a period of three months after the date of receipt of the notification by OECD. Pursuant to section 49(1A) of IRO, CE-in-C shall make an order¹¹ to declare that the Multilateral Convention shall have effect in Hong Kong.

Major views and concerns expressed by Members

14. FA Panel was consulted on the proposed extension of the Multilateral Convention to Hong Kong at the meeting on 5 June 2017. The major views and concerns expressed by members at the meeting are summarized in the ensuing paragraphs.

Procedures for Hong Kong to join the Convention on Mutual Administrative Assistance in Tax Matters

15. Members enquired about the procedures for Hong Kong to join the Multilateral Convention, given that the Multilateral Convention was only opened for signature by state parties.

16. The Government advised that upon the request of Hong Kong, CPG had recently given in-principle approval to extend the application of the Multilateral Convention to Hong Kong. The Government had to amend IRO to provide for the legislative framework for Hong Kong to participate in the Multilateral Convention. Upon enactment of the amendment ordinance, the Government would seek CPG's assistance to deposit a declaration to OECD for territorial application of the Multilateral Convention to Hong Kong.

Implementation strategy of Hong Kong

17. Noting that "simultaneous tax examinations" was one of the mandatory provisions of the Multilateral Convention, but it would be up to a party to decide whether to participate in a particular examination, members enquired about the purpose of conducting simultaneous tax examinations and the reasons for the Government's decision of not participating in any simultaneous tax examinations.

¹⁰ Hong Kong intends to take forward the mandatory provisions of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters only while making suitable reservations/declarations for the optional provisions so that such provisions will not apply (or will only apply partially) to Hong Kong.

¹¹ The order is subject to the negative vetting procedure of LegCo.

18. The Government explained that simultaneous tax examination referred to an arrangement which jurisdictions, each in its own territory, to examine tax affairs of persons in which they had a common or related interest, with a view to exchanging any relevant information which they so obtained. Given that Hong Kong had been practising a territorial-based tax regime, it appeared unlikely that Hong Kong would need to conduct tax examinations with other jurisdictions. It was therefore the Government's policy that Hong Kong, as a general rule, would not participate in any simultaneous tax examinations. In addition, Hong Kong would not accept requests from other jurisdictions allowing their representatives to be present at a tax examination of Hong Kong given that "tax examinations abroad" was an optional provision of the Multilateral Convention.

19. As regards the types of taxes that Hong Kong intended to cover under the Multilateral Convention, the Government advised that a wide range of taxes were covered under the Multilateral Convention and Hong Kong would only provide assistance on information exchange for taxes on income or profits, taxes on capital gains which were imposed separately from the tax on income or profits, and taxes on net wealth (i.e. the minimum requirement under the Multilateral Convention).

Latest development

20. At the FA Panel meeting on 18 December 2017, the Government will brief members on the key steps in extending the Multilateral Convention to Hong Kong, after passage of the Amendment (No.5) Bill 2017.

Relevant papers

21. A list of relevant papers is set out in **Appendix II**.

Criteria adopted by the Organisation for Economic Co-operation and Development and the European Union for considering non-cooperative tax jurisdictions and non-compliant jurisdictions on tax transparency

A jurisdiction will be considered by the Organisation for Economic Co-operation and Development as "non-cooperative" if it fails to meet the benchmarks of at least two of the following three criteria-

- (a) exchange of information on request ("EOIR") - obtain at least a rating of "Largely Compliant" from the Global Forum on Transparency and Exchange of Information for Tax Purposes ("Global Forum");
- (b) automatic exchange of financial account information in tax matters ("AEOI") - first exchanges commence in 2018 (with respect to the financial account information for the year 2017) at the latest; and
- (c) the Multilateral Convention on Mutual Administrative Assistance in Tax Matters ("Multilateral Convention") - participation in the Multilateral Convention or a sufficiently broad exchange network permitting both EOIR and AEOI.

1. In the case of the European Union ("EU"), a jurisdiction will be regarded as compliant on tax transparency if it fulfills at least two of the following three criteria-

- (a) EOIR - obtain at least a rating of "Largely Compliant" from the Global Forum;
- (b) AEOI - arrangement in place for exchange with all Member States of EU by end 2017, either by signing the Multilateral Competent Authority Agreement ("CAA") or through bilateral CAAs; and
- (c) Multilateral Convention - participation in the Multilateral Convention, or having a network of agreements covering all Member States of EU (allowing both EOIR and AEOI), either already in force or expected to enter into force within a reasonable time frame.

List of relevant papers

Date	Event	Paper
3 November 2014	Meeting of the FA Panel	<p>Administration's paper (LC Paper No. CB(1)122/14-15(03))</p> <p>Background brief (LC Paper No. CB(1)122/14-15(04))</p> <p>Minutes (paragraphs 38-51) (LC Paper No. CB(1)379/14-15)</p>
30 March 2015	Special meetings of the Finance Committee to examine the Estimates of Expenditure 2015-16 (session on public finance)	<p>Speaking note of the Secretary for Financial Services and the Treasury</p> <p>Report on the examination of the Estimates of Expenditure 2015-2016</p>
6 July 2015	Meeting of the FA Panel	<p>Administration's paper (LC Paper No. CB(1)1034/14-15(06))</p> <p>Updated background brief (LC Paper No. CB(1)1034/14-15(07))</p> <p>Minutes (paragraphs 54-64) (LC Paper No. CB(1)1258/14-15)</p>
22 June 2016	The Legislative Council passed the Inland Revenue (Amendment) Bill 2016	<p>Hansard</p> <p>The Bill passed</p> <p>Report of the Bills Committee (LC Paper No. CB(1)984/15-16)</p>
2 November 2016	Subcommittee on Inland Revenue Ordinance (Amendment of Schedule 17E) Notice 2016	<p>Report (LC Paper No. CB(1)281/16-17)</p>

Date	Event	Paper
16 March 2017	Meeting of the FA Panel	<p><u>Administration's paper</u> (LC Paper No. CB(1)660/16-17(09))</p> <p><u>Updated background brief</u> (LC Paper No. CB(1)660/16-17(10))</p> <p><u>Minutes</u> (paragraphs 56-61) (LC Paper No. CB(1)1178/16-17)</p>
29 March 2017	The Legislative Council passed the Inland Revenue (Amendment) (No.3) Bill 2017	<p><u>Hansard</u></p> <p><u>The Bill passed</u></p> <p><u>Report of the Bills Committee</u> (LC Paper No. CB(1)1008/16-17)</p>
3 April 2017	Special meetings of the Finance Committee to examine the Estimates of Expenditure 2017-18 (session on public finance)	<p><u>Speaking note of the Secretary for Financial Services and the Treasury</u></p> <p><u>Report on the examination of the Estimates of Expenditure 2017-2018</u></p>
5 June 2017	Meeting of the FA Panel	<p><u>Administration's paper</u> (LC Paper No. CB(1)1030/16-17(08))</p> <p><u>Updated background brief</u> (LC Paper No. CB(1)1030/16-17(09))</p> <p><u>Minutes</u> (paragraphs 52-62) (LC Paper No. CB(1)1356/16-17)</p>
18 October 2017	The Inland Revenue Revenue (Amendment) (No. 5) Bill 2017 was introduced into the Legislative Council	<p><u>The Bill</u></p> <p><u>Legislative Council Brief</u> (File Ref: TsyB R 00/800-2/20/0(C))</p> <p><u>Legal Service Division Report</u> (LC Paper No. LS5/17-18)</p>