

**For discussion
on 2 March 2020**

Legislative Council Panel on Financial Affairs

**Automatic Exchange of Financial Account Information
in Tax Matters**

Purpose

This paper briefs Members on the implementation of automatic exchange of financial account information in tax matters (“AEOI”) in Hong Kong and the proposed amendments to the Inland Revenue Ordinance (Cap. 112) (“IRO”) for implementing the recommendations from the Organisation for Economic Co-operation and Development (“OECD”).

Implementation of AEOI in Hong Kong

2. AEOI is an initiative on exchange of tax information advocated by the OECD to enhance tax transparency and combat cross-border tax evasion. Under the Common Reporting Standard (“CRS”) promulgated by the OECD to underpin the implementation of AEOI, a reporting financial institution (“FI”)¹ is required to identify financial accounts held by tax residents of reportable jurisdictions (as specified in Part 1 of Schedule 17E to the IRO) in accordance with the due diligence procedures. FIs need to collect the reportable information of these accounts² and furnish such information to the tax authority, i.e. Inland

¹ Under section 50A(1) of the IRO, “financial institution” means a custodial institution, a depository institution, an investment entity or a specified insurance company. The term principally refers to banks, securities firms, insurance companies and investment funds. On the other hand, “reporting financial institution” is defined to mean, in general, a FI that is resident in Hong Kong or a Hong Kong branch of a FI that is not resident in Hong Kong.

² The financial information to be reported with respect to reportable accounts includes all types of investment income (including interest, dividends, income from certain insurance contracts and other similar types of income), account balances and sales proceeds from financial assets.

Revenue Department (“IRD”) in the case of Hong Kong. IRD then exchanges the information with the tax authorities of Hong Kong’s AEOI partner jurisdictions on an annual basis via an electronic system established by the OECD. We amended the IRO in June 2016 to provide a legal framework for implementing AEOI in Hong Kong. IRD has established a dedicated platform, i.e. the AEOI Portal, for reporting FIs to electronically submit notifications and furnish Financial Account Information Returns for reporting the required information of reportable accounts.

3. Reciprocally, Hong Kong receives financial account information in respect of Hong Kong tax residents who hold financial accounts in our respective AEOI partner jurisdictions. The information received facilitates the work of IRD in tax compliance, e.g. establishment of risk profiles and development of new risk typologies for tax audits.

4. Hong Kong conducted two rounds of AEOI since the first exchange conducted in September 2018. Around 1 100 reporting FIs furnished Financial Account Information Returns to IRD in each exercise. IRD conducted AEOI with 45 jurisdictions in 2018 and the number increased to 51 jurisdictions in 2019. Hong Kong exchanges information with AEOI partner jurisdictions on the basis of comprehensive avoidance of double taxation agreements (“CDTAs”) or the Convention on Mutual Administrative Assistance in Tax Matters (“Convention”). All CDTAs signed by Hong Kong as well as the Convention include safeguards for protecting data privacy and confidentiality of the information exchanged and ensuring that secrecy is not compromised.

5. To facilitate compliance with AEOI, IRD has promulgated a guideline for reporting FIs³ and set up designated email accounts for addressing related enquiries. IRD also conducted briefings on the AEOI requirements for stakeholders and will continue to do so.

³ The Guidance for Financial Institutions is available at the IRD’s website at <https://www.ird.gov.hk/eng/pdf/2016/guidance.pdf>.

OECD's Recommendations and Proposed Legislative Amendments

6. The OECD attaches great importance to the consistent application of the CRS among all participating jurisdictions. So far, 112 jurisdictions have implemented AEOI or have a definitive plan for implementing AEOI⁴. From time to time, the OECD conducts assessments on the compliance of participating jurisdictions with the CRS. In recent years, the OECD reviewed Hong Kong's legislative framework and made recommendations thereon. In response, we introduced corresponding legislative amendments to the IRO⁵.

7. The OECD is currently conducting another round of assessment on the AEOI legislative framework of Hong Kong, and has made two improvement recommendations. The assessment forms part of the peer review process on Hong Kong's delivery of its commitment to implement the AEOI. Hence, Hong Kong needs to introduce amendments, which are largely technical in nature, to the IRO so as to ensure that our AEOI regime continues to comply with the prevailing international standard.

8. The first OECD's recommendation is about the definition of "controlling person". The OECD considers that the existing definition in the IRO is not fully consistent with that set out in the CRS. Specifically, the identification of beneficial owners of a partnership under the IRO for the purpose of AEOI is only applicable to, amongst others, those individuals who are entitled to or control more than 25% of the capital/profits/voting rights of the partnership (see section 50A(6)(b) and 50A(7) of the IRO), while the OECD considers that the scope of beneficial owners of partnerships should not be subject to any thresholds on the stakes held⁶. To comply with the OECD's requirement, we need to remove the 25% threshold applicable to partnerships. We will also

⁴ 45 other jurisdictions have joined the AEOI initiative but have yet to set the date for first automatic exchange.

⁵ The Inland Revenue (Amendment) Ordinance 2018 and the Inland Revenue (Amendment) (No. 2) Ordinance 2019 were enacted to, among others, introduce technical refinements to the AEOI legislative framework.

⁶ CRS requires that the controlling persons that need to be identified in relation to legal arrangements (covering partnerships in the case of Hong Kong) are those that hold a similar position as settlor, trustee, protector and beneficiary of a trust, regardless of the stake held.

take the opportunity to remove a similar threshold applicable to trusts for the sake of completeness⁷.

9. The second recommendation from the OECD is for enhancing the legislative clarity. Currently, the IRO provides that a reporting FI may rely on information collected and maintained pursuant to the anti-money laundering/know your customer (“AML/KYC”) procedures for the purpose of determining the controlling persons of an account holder of a new entity account. The OECD considers that Hong Kong should clearly specify that such AML/KYC procedures, if relied upon, must be consistent with Recommendations 10 and 25 of the Financial Action Task Force Recommendations (as adopted in February 2012).

Feedback from stakeholders

10. In November 2019, we issued letters to relevant stakeholders from the financial, business, accounting and legal sectors to brief them on the OECD’s recommendations and seek their views on the proposed legislative amendments. Most of the submissions received indicate no objection or no comment towards the proposed legislative amendments.

11. We note that the FIs concerned will need to undertake additional compliance work in response to the OECD’s latest view on the definition of “controlling person” of partnerships. Since the CRS is an international tax standard and all participating jurisdictions of AEOI are expected to apply it consistently, it is not an option for Hong Kong to depart from the CRS. As usual, IRD will continue to provide guidance to FIs on the refinements of AEOI.

Legislative Timetable

12. The Secretary for Financial Services and the Treasury will make Gazette notices under sections 50A(16A) and 50J of the IRO in order to

⁷ In relation to trusts (which are also regarded as legal arrangements by the OECD), while the 25% threshold still exists under section 50A(6)(c)(i) and 50A(7) of the IRO, section 50A(6)(c)(ii) to (vi), as amended by the Inland Revenue (Amendment) (No. 2) Ordinance 2019, has already provided that all controlling persons as defined by the CRS, regardless of the stake held, have to be identified by the reporting FIs, thereby satisfying the OECD’s requirement. Nonetheless, we propose to take this opportunity to remove the 25% threshold applicable to trusts for the sake of completeness.

implement the OECD's recommendations. The Gazette notices will take the form of subsidiary legislation subject to negative vetting by the LegCo.

13. Subject to Members' views, we plan to table the subsidiary legislation at the LegCo in April 2020 with a view to completing the legislative procedures in June 2020. We shall propose that the amendments come into force on 1 January 2021 so as to facilitate reporting FIs to prepare for the enhanced requirements.

Advice Sought

14. Members are invited to note the latest implementation of AEOI in Hong Kong, and comment on the proposed legislative amendments in response to the OECD's recommendations.

**Financial Services and the Treasury Bureau
Inland Revenue Department
February 2020**