

LEGISLATIVE COUNCIL BRIEF

Inland Revenue Ordinance
(Chapter 112)

INLAND REVENUE (AMENDMENT) (NO. 3) BILL 2017

INTRODUCTION

A At the meeting of the Executive Council on 21 March 2017, the Council ADVISED and the Chief Executive ORDERED that the Inland Revenue (Amendment) (No.3) Bill 2017 (the “Bill”), at **Annex A**, should be introduced into the Legislative Council (“LegCo”) to mandate financial institutions (“FIs”)¹ in Hong Kong to conduct due diligence and collect the required information from account holders who are tax residents of *prospective* and *confirmed* AEOI partners of Hong Kong in respect of automatic exchange of financial account information in tax matters (“AEOI”), and furnish the Inland Revenue Department (“IRD”) with the relevant information so collected.

JUSTIFICATIONS

Implementation of AEOI in Hong Kong

2. The Organisation for Economic Co-operation and Development (“OECD”) promulgated the new international standard for AEOI in July 2014 with a view to enhancing tax transparency and combating cross-border tax evasion. In September 2014, Hong Kong indicated its support for implementing AEOI on a bilateral 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.

¹ FIs are defined in the IRO to mean custodial institutions, depository institutions, investment entities and specified insurance companies. They principally refer to banks, securities firms, insurance companies and investment funds.

3. We amended the Inland Revenue Ordinance (“IRO”) in June 2016 to put in place a legal framework for implementing AEOI. An FI is required to-

- (a) conduct due diligence procedures to identify financial accounts held by tax residents of “reportable jurisdictions” (i.e. jurisdictions with which Hong Kong will conduct AEOI, as specified in Part 1 of Schedule 17E to the IRO);
- (b) collect the required information in relation to these reportable accounts (i.e. the **targeted approach**); and
- (c) furnish the IRD with such information from a specified reporting year for onward exchange with the relevant AEOI partner.

The IRO also allows an FI to apply the stipulated procedures to identify and collect the required information in respect of accounts held by tax residents of jurisdictions outside Hong Kong² (i.e. the **wider approach**) though it is not a mandatory requirement. The adoption of a targeted approach for FIs to collate account information primarily aims to minimise the compliance burden for FIs.

4. After establishing the legal framework for implementing AEOI, we have signed bilateral Competent Authority Agreements (“BCAAs”) with Japan and the United Kingdom respectively 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 the IRO, so that FIs can conduct their due diligence and data collection accordingly. In October 2016, Hong Kong indicated that it will expand its AEOI network to cover all our tax treaty partners³ committed to adopting AEOI, and IRD has approached them for BCAA discussions. We have subsequently signed BCAAs with Belgium, Canada, Guernsey, Italy, Korea, Mexico and the Netherlands for conducting AEOI.

Changing International Landscape

5. The international community has been closely monitoring jurisdictions’ progress

² Or in respect of accounts held by passive Non-Financial Entities (passive NFEs as defined in the IRO) whose controlling persons are tax residents of jurisdictions outside Hong Kong.

³ Hong Kong’s tax treaty partners refer to jurisdictions with which Hong Kong has signed comprehensive avoidance of double taxation agreements (“CDTAs”) or tax information exchange agreements (“TIEAs”). 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.

in the implementation of AEOI and putting emphasis on a wide network of AEOI to ensure a level-playing field. While Hong Kong is on its way to commencing the first automatic exchanges with a number of jurisdictions in 2018, both the OECD⁴ and the European Union (“EU”)⁵ have kicked off their respective exercises to draw up lists of “non-cooperative tax jurisdictions”. One of the listing criteria is the progress and the network of implementing AEOI. In the case of the EU, a jurisdiction could be regarded as compliant on tax transparency if it fulfils at least two of the three criteria (see footnote 5). One of which is arrangement has been in place for AEOI with all Member States of the EU by end 2017. A considerable number of jurisdictions have also indicated to OECD their interest in conducting AEOI with Hong Kong.

6. In view of the latest developments, Hong Kong needs to expand our AEOI network quickly so as to preserve information covering the period starting from the second half of 2017 for exchange. A jurisdiction listed as “non-cooperative” could be subject to **counter-measures** which would make it a less attractive place for investment and business. Such counter-measures might include the imposition of withholding taxes and non-deductibility of costs of transactions by other jurisdictions.

Constraints for Expanding Hong Kong's AEOI network

7. While Hong Kong has pledged to expand its network of AEOI to cover all our tax treaty partners committed to adopting AEOI, and has approached them for BCAA discussions, we face two key constraints in the negotiations because-

⁴ At the Leaders' Summit in Hangzhou in September 2016, G20 Leaders endorsed the three criteria proposed by the OECD for identifying non-cooperative tax jurisdictions. A jurisdiction would be considered “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) AEOI - first exchanges commence in 2018 (with respect to the **financial account information for the year 2017**) at the latest; and
- (c) the 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.

⁵ The EU endorsed in November 2016 three criteria for its screening exercise. A jurisdiction could be regarded by EU as compliant on tax transparency if it fulfils **at least two of the following three criteria-**

- (a) AEOI - arrangement in place for exchange with **all Member States of EU by end 2017**, either by signing the Multilateral Competent Authority Agreement or through bilateral agreements (and in future obtain at least a rating of "Largely Compliant" from the Global Forum);
- (b) EOIR - obtain at least a rating of “Largely Compliant” from Global Forum; and
- (c) the 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.

- (a) BCAA discussions with individual jurisdictions would take time. In many cases, our bilateral tax treaties (i.e. CDTAs and TIEAs) would need to be amended to allow for AEOI.
- (b) FIs are currently mandated to take the targeted approach only, i.e. identify and collect information in relation to accounts held by tax residents of **confirmed** AEOI partners as included in the list of “reportable jurisdictions” in the IRO. FIs have no obligation to do the same in respect of tax residents of a **prospective** AEOI partner, and this makes it difficult for Hong Kong to exchange back-year data (i.e. account information from 1 January 2017 until the time a jurisdiction becomes a reportable jurisdiction) with jurisdictions who become our AEOI partner in the future. Since only confirmed AEOI partners would be included in the list of reportable jurisdictions, the current list only contains two jurisdictions⁶. The targeted approach coupled with a list of handful “reportable jurisdictions” could lead to “information loss” as raised by some of our treaty partners. The 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**.

8. To overcome the above challenges and to expand our AEOI network speedily, we consider it important for Hong Kong to amend the IRO so as 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.

Proposal

9. We propose to include 65 prospective AEOI partners and seven confirmed AEOI partner (being Belgium, Canada, Guernsey, Italy, Korea, Mexico and the Netherlands) as Hong Kong’s “reportable jurisdictions”, on top of the two already included in the list (i.e. B Japan and the United Kingdom), with effect from 1 July 2017 (see **Annex B**). The 65 prospective AEOI partners are from the following three categories—

- (a) jurisdictions which expressed an interest to OECD in late 2016 in conducting AEOI with Hong Kong;

⁶ Whilst Belgium, Canada, Guernsey, Italy, Korea, Mexico and the Netherlands (with each of which Hong Kong has already signed a BCAA) are also confirmed AEOI partners, they have yet to be included in the list of reportable jurisdictions. We plan to include these seven jurisdictions together with 65 prospective AEOI partners in the list of reportable jurisdictions in one go.

(b) Hong Kong's tax treaty partners which have committed to AEOI; and

(c) all Member States of the EU.

The proposal is meant to take effect from **1 July 2017**. This means that all FIs would be obliged from that day onwards to identify and collect information on accounts of tax residents in 74 jurisdictions (72 new + Japan and the United Kingdom).

10. Whilst the data collection obligation starts from 1 July 2017, the “reporting year” in the proposed new schedule is “2018”. In practice, IRD will call on the FIs to submit the relevant data by May 2018, so that after consolidation, IRD can conduct the exchange in September 2018 for jurisdictions which have by then signed BCAAs with Hong Kong in accordance with the OECD requirement. We would like to emphasize that exchange will be conducted only with a reportable jurisdiction when a CDTA / TIEA (having effect under section 49(1A) of the IRO) is in place to provide the basis for exchange, together with a BCAA signed on that basis for conducting AEOI.

11. For the **first round of reporting** in 2018, FIs will be asked to furnish, for the 72 newly-added reportable jurisdictions, data with respect to the period from 1 July to 31 December 2017, whereas for Japan and the United Kingdom, data with respect to the period from 1 January 2017 to 31 December 2017. In **subsequent years**, FIs are expected to furnish IRD with full-year data for all jurisdictions included as “reportable jurisdictions”. This would help ease the compliance burden on FIs by sparing their need to collect past information for individual jurisdictions at different points in time whenever Hong Kong enters in AEOI with a new jurisdiction and the back-year data could be efficiently collated and stored. The information so reported to IRD would be exchanged with the jurisdiction concerned **only after** an AEOI agreement with the necessary data protection safeguards has been put in place.

Related Matters

12. Apart from seeking to expand the list of “reportable jurisdictions” to cover prospective AEOI partners of Hong Kong, we will also seek to conclude AEOI agreements with more jurisdictions on a bilateral basis⁷. At present, Hong Kong is not covered by the Multilateral Convention, which provides a basis for jurisdictions to conduct AEOI on a

⁷ It has been Hong Kong's intention to conduct AEOI on a bilateral basis with our tax treaty partners. However, among the 100 jurisdictions that have committed to AEOI, so far only six jurisdictions have planned to implement AEOI on a bilateral basis.

multilateral basis. We note that, for those 100 jurisdictions committed to AEOI, over 90 have participated in the Multilateral Convention (either as a signatory or as a territory covered by way of territorial extension). We are now considering the possibility of seeking the application of the Multilateral Convention to Hong Kong for conducting AEOI. We will keep stakeholders informed of the progress in this regard. Indeed, as illustrated in footnotes 4 and 5, the participation in the Multilateral Convention is one of the assessment criteria for OECD and EU in identifying “non-cooperative” tax jurisdictions.

OTHER OPTIONS

13. The IRO has to be amended in order to bring our proposals into effect. There are no other options.

THE BILL

14. The main provisions of the Bill are as follows –

- (a) **Clause 1** stipulates that the enacted Ordinance comes into operation on 1 July 2017;
- (b) **Clause 3** amends the definition of “reportable jurisdiction” in section 50A of the IRO to include territories outside Hong Kong irrespective of whether they are parties to the arrangements having effect under section 49(1A) of the IRO and requiring disclosure of information concerning tax of the territories;
- (c) **Clause 4** amends Part 1 of Schedule 17E to the IRO to add 72 jurisdictions to the list of reportable jurisdictions.

LEGISLATIVE TIMETABLE

15. The legislative timetable will be as follows–

Publication in the Gazette	24 March 2017
First Reading and commencement of Second Reading debate	29 March 2017
Resumption of Second Reading debate, committee stage and Third Reading	to be notified

IMPLICATIONS OF THE PROPOSAL

16. The proposal is in conformity with the Basic Law, including the provisions concerning human rights. The proposal will not affect the binding effect of the existing provisions of the IRO and its subsidiary legislation. It has no environmental, gender, family, productivity or sustainability implications.

17. As for economic implications, the proposal will demonstrate Hong Kong's commitment to enhance our tax transparency and participate in international tax cooperation. This is particularly crucial for Hong Kong to preserve our competitiveness and reputation as an international financial and business centre, and to avoid being listed as a "non-cooperative" tax jurisdiction. For financial and civil service implications, additional resources have been earmarked for Financial Services and the Treasury Bureau and IRD in 2017-18 and beyond to cope with treaty negotiations, stakeholders' engagement, legislative exercises and implementation work arising from the international tax cooperation.

PUBLIC CONSULTATION

18. We issued an information note to our stakeholders, including key FI groups, regulators, professional associations and business chambers in mid-February 2017 to update them of the latest international developments and Government's revised implementation strategy. A briefing session for the stakeholders was also held on 3 March 2017.

19. In general, our stakeholders understood the latest international developments on AEOI and supported Hong Kong's continued commitments in the implementation of this international drive. At the same time, there were concerns about the implementation timetable of AEOI in Hong Kong, such as the timing for FIs to furnish returns on information in relation to reportable accounts and the timeline for IRD to exchange information with other jurisdictions. We assured our stakeholders that, while FIs would be required to collect information on tax residents of more reportable jurisdictions, IRD would only exchange such information with those reportable jurisdictions upon the signing of the relevant AEOI agreements.

20. We also briefed the Panel on Financial Affairs of the Legislative Council at its meeting on 16 March 2017 and the Panel raised no objection to the proposal.

PUBLICITY

21. To enhance the awareness of the general public on AEOI and to facilitate FIs' work, a television and radio Announcement in the Public Interest has been broadcast since December 2016 and posters were produced for FIs' deployment. We will continue our close liaison with stakeholders in ensuring a smooth implementation of the revised AEOI requirements.

22. We will issue a press release and arrange a spokesperson to answer media enquiries.

BACKGROUND

23. Together with 99 other jurisdictions, Hong Kong has joined the AEOI global initiative. The IRO was amended in June 2016 to put in place a legal framework for the implementation of AEOI in Hong Kong. Hong Kong signed agreements with nine jurisdictions for conducting AEOI on a bilateral basis.

ENQUIRIES

24. Enquiries on this Brief can be addressed to Mr Gary Poon, Principal Assistant Secretary for Financial Services and the Treasury (Treasury), at 2810 2370.

Financial Services and the Treasury Bureau

22 March 2017

A BILL

To

Amend the Inland Revenue Ordinance to expand the list of reportable jurisdictions for the more effective implementation of the arrangement relating to automatic exchange of financial account information in tax matters.

Enacted by the Legislative Council.

1. Short title and commencement

- (1) This Ordinance may be cited as the Inland Revenue (Amendment) (No. 3) Ordinance 2017.
- (2) This Ordinance comes into operation on 1 July 2017.

2. Inland Revenue Ordinance amended

The Inland Revenue Ordinance (Cap. 112) is amended as set out in sections 3 and 4.

3. Section 50A amended (interpretation)

Section 50A(1), definition of *reportable jurisdiction*—

Repeal

everything after “Hong Kong”

Substitute

“that is specified in column 1 of Part 1 of Schedule 17E;”.

4. Schedule 17E amended (reportable jurisdictions and participating jurisdictions)

Schedule 17E, Part 1—

Repeal everything after the heading and before the Note
Substitute

“Column 1 Reportable jurisdiction	Column 2 Reporting year
Antigua and Barbuda	2018
Argentina, Republic of	2018
Australia, Commonwealth of	2018
Austria, Republic of	2018
Bahamas, Commonwealth of the	2018
Belgium, Kingdom of	2018
Brazil, Federative Republic of	2018
Brunei Darussalam	2018
Bulgaria, Republic of	2018
Canada	2018
Cayman Islands	2018
Chile, Republic of	2018
China, Mainland of	2018
Colombia, Republic of	2018
Costa Rica, Republic of	2018
Croatia, Republic of	2018
Curacao, Country of	2018
Cyprus, Republic of	2018

Clause 4

3

Column 1 Reportable jurisdiction	Column 2 Reporting year
Czech Republic	2018
Denmark, Kingdom of	2018
Estonia, Republic of	2018
Faroes	2018
Finland, Republic of	2018
French Republic	2018
Germany, Federal Republic of	2018
Gibraltar	2018
Greenland	2018
Grenada	2018
Guernsey	2018
Hellenic Republic (Greece)	2018
Hungary, Republic of	2018
Iceland, Republic of	2018
India, Republic of	2018
Indonesia, Republic of	2018
Ireland	2018
Isle of Man	2018
Israel, State of	2018
Italian Republic	2018
Japan	2018
Jersey	2018
Korea, Republic of	2018

Clause 4

4

Column 1 Reportable jurisdiction	Column 2 Reporting year
Kuwait, State of	2018
Latvia, Republic of	2018
Lebanon, Republic of	2018
Liechtenstein, Principality of	2018
Lithuania, Republic of	2018
Luxembourg, Grand Duchy of	2018
Malaysia	2018
Malta	2018
Mauritius, Republic of	2018
Montserrat	2018
Netherlands, Kingdom of the	2018
New Zealand	2018
Norway, Kingdom of	2018
Poland, Republic of	2018
Portuguese Republic	2018
Qatar, State of	2018
Romania	2018
Russian Federation	2018
Saint Vincent and the Grenadines	2018
Saudi Arabia, Kingdom of	2018
Seychelles, Republic of	2018
Singapore, Republic of	2018
Slovak Republic	2018

Column 1 Reportable jurisdiction	Column 2 Reporting year
Slovenia, Republic of	2018
South Africa, Republic of	2018
Spain, Kingdom of	2018
Sweden, Kingdom of	2018
Swiss Confederation	2018
United Arab Emirates	2018
United Kingdom of Great Britain and Northern Ireland	2018
United Mexican States	2018
Uruguay, Oriental Republic of	2018
Vanuatu, Republic of	2018”.

Explanatory Memorandum

Under Part 8A of the Inland Revenue Ordinance (Cap. 112) (*Ordinance*), a financial institution is required to conduct due diligence procedures to identify financial accounts held by tax residents of reportable jurisdictions, collect the required information in respect of the accounts, and furnish the Inland Revenue Department with the information for exchange with the relevant reportable jurisdictions. Those reportable jurisdictions, as defined in section 50A of the Ordinance, are territories outside Hong Kong that are parties to arrangements having effect under section 49(1A) of the Ordinance and requiring disclosure of information concerning tax of the territories (*arrangements*), and that are specified in Part 1 of Schedule 17E to the Ordinance.

2. This Bill seeks to amend section 50A of, and Schedule 17E to, the Ordinance.
3. Clause 3 amends the definition of *reportable jurisdiction* in section 50A so that reportable jurisdictions can include territories outside Hong Kong irrespective of whether they are parties to the arrangements.
4. Clause 4 amends Part 1 of Schedule 17E to add 72 jurisdictions to the list of reportable jurisdictions (in addition to the 2 jurisdictions already included in the current list).

Proposed Revised List of Reportable Jurisdictions of Hong Kong

1. Antigua and Barbuda
2. Argentina
3. Australia
4. Austria[@]
5. Bahamas
6. Belgium^{@*}
7. Brazil
8. Brunei Darussalam[@]
9. Bulgaria
10. Canada^{@*}
11. Cayman Islands
12. Chile
13. The Mainland of China[@]
14. Colombia
15. Costa Rica
16. Croatia
17. Curacao
18. Cyprus
19. Czech Republic[@]
20. Denmark[@]
21. Estonia
22. Faroe Islands[@]
23. Finland
24. France[@]
25. Germany
26. Gibraltar
27. Greece
28. Greenland[@]
29. Grenada
30. Guernsey^{@*}
31. Hungary[@]
32. Iceland[@]
33. India
34. Indonesia[@]
35. Ireland[@]
36. Isle of Man
37. Israel
38. Italy^{@*}
39. Japan^{@#}
40. Jersey[@]
41. Korea^{@*}
42. Kuwait[@]
43. Latvia[@]
44. Lebanon
45. Liechtenstein[@]
46. Lithuania
47. Luxembourg[@]
48. Malaysia[@]
49. Malta[@]
50. Mauritius
51. Mexico^{@*}
52. Montserrat
53. Netherlands^{@*}
54. New Zealand[@]
55. Norway[@]
56. Poland
57. Portugal[@]
58. Qatar[@]
59. Romania[@]
60. Russia[@]
61. Saint Vincent and the Grenadines
62. Saudi Arabia
63. Seychelles
64. Singapore
65. Slovak Republic
66. Slovenia
67. South Africa[@]
68. Spain[@]
69. Sweden[@]
70. Switzerland[@]
71. United Arab Emirates[@]
72. United Kingdom^{@#}
73. Uruguay
74. Vanuatu

[#] Confirmed AEOI partner already included in the existing list of reportable jurisdictions

^{*} Confirmed AEOI partner not yet included in the existing list of reportable jurisdictions

[@] Hong Kong's existing tax treaty partners committed to AEOI