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LEGISLATIVE COUNCIL BRIEF

Inland Revenue Ordinance
(Chapter 112)

INLAND REVENUE (MULTILATERAL CONVENTION TO IMPLEMENT TAX TREATY RELATED MEASURES TO PREVENT BASE EROSION AND PROFIT SHIFTING) ORDER

INTRODUCTION

At the meeting of the Executive Council on 20 September 2022, the Council ADVISED and the Chief Executive ORDERED that the Inland Revenue (Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting) Order ("Order"), at
A **Annex A**, should be made under section 49(1A) of the Inland Revenue Ordinance (Cap. 112) ("IRO") to give effect to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting ("Multilateral Instrument") in the Hong Kong Special Administrative Region ("Hong Kong").

JUSTIFICATIONS

Multilateral Instrument

2. The Organisation for Economic Co-operation and Development ("OECD") released a package of 15 actions in October 2015 to counter base erosion and profit shifting ("BEPS") by multinational enterprises. BEPS refers to tax avoidance strategies of multinational enterprises in exploiting the gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity. Hong Kong indicated to the OECD in June 2016 its commitment to implementing the minimum standards of the BEPS package. Amongst these minimum standards are measures to prevent the abuse of Comprehensive Avoidance of Double Taxation Agreements/Arrangements

("CDTAs")[1] through preventing the granting of tax treaty benefits in inappropriate circumstances and improve the dispute resolution mechanism provided for in CDTAs.

3. The Multilateral Instrument enables the application of our CDTAs to be modified so as to effectively implement the tax treaty-related minimum standards of the BEPS package. The Multilateral Instrument was developed by the OECD as part of the BEPS package to ensure swift, co-ordinated and consistent implementation of treaty-related BEPS measures in a multilateral context. As at 16 September 2022, 99 jurisdictions have joined the Multilateral Instrument. The wide participation in the Multilateral Instrument obviates the need for cumbersome bilateral tax treaty negotiations amongst jurisdictions for modifying the relevant tax treaty provisions in a piecemeal manner.

4. China became a signatory to the Multilateral Instrument in June 2017. Having sought the views of the Government of the Hong Kong Special Administrative Region ("HKSARG"), the Central People's Government ("CPG") decided to extend the application of the Multilateral Instrument to Hong Kong. On 25 May 2022, the CPG deposited the instrument of approval of the Multilateral Instrument with the OECD. The Multilateral Instrument will enter into force for China (including Hong Kong) on 1 September 2022[2]. When depositing the instrument of approval, the CPG also, in consultation with the HKSARG, made a list of reservations and notifications applicable to Hong Kong under the Multilateral Instrument[3]. The provisions of the Multilateral Instrument will take effect in Hong Kong only after completion of the domestic legislative procedures.

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[1] A CDTA sets out the allocation of taxing rights between two tax jurisdictions, thereby facilitating assessment of potential tax liabilities arising from cross-border economic activities and hence providing enhanced certainty to business people and investors. It facilitates the flow of investment, technology, talents and expertise.

[2] According to Article 34 of the Multilateral Instrument, the Multilateral Instrument will enter into force on the first day of the month following the expiration of a period of three calendar months after the deposit of the instrument of approval.

[3] Pursuant to the Multilateral Instrument, a jurisdiction may reserve the right for certain articles not to apply to its CDTAs and make notifications regarding its stance on certain matters raised in individual articles. Details of the reservations and notifications applicable to Hong Kong are set out in Schedule 2 to the Order.

Scope of Application of the Multilateral Instrument in Hong Kong

5. The Multilateral Instrument contains both mandatory[4] and optional[5] provisions. When a public consultation exercise regarding the proposed implementation strategy for the BEPS package was conducted in end-2016, we received feedback in support of the use of the Multilateral Instrument for obviating the need to individually amend bilateral tax treaties and providing greater tax certainty. In the light of this, we will implement only the mandatory provisions of the Multilateral Instrument (save for an optional provision under Article 6) and opt out of the remaining optional provisions. This minimalist approach will serve to minimise any additional compliance burden on taxpayers.

6. The effects of the provisions of the Multilateral Instrument to be implemented in Hong Kong and their impact on taxpayers in respect of a CDTA intended by both Hong Kong and the CDTA partner to be covered by the Multilateral Instrument (hereinafter referred to as a "Covered CDTA") are set out below –

(a) the mandatory provision under Article 6 (Purpose of a Covered Tax Agreement) modifies the preamble of the Covered CDTAs to include an express statement that the common intention of the contracting parties is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance, including through treaty-shopping arrangements. Adopting the provision can give the contracting parties to the Covered CDTAs protection against treaty abuse without imposing any substantive impact on taxpayers;

(b) Article 7 (Prevention of Treaty Abuse) modifies the Covered CDTAs to provide for a general anti-abuse rule based on the

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[4] The mandatory provisions implement the treaty-related minimum standards, which are provided for under Article 6 (Purpose of a Covered Tax Agreement), Article 7 (Prevention of Treaty Abuse) and Article 16 (Mutual Agreement Procedure).

[5] Optional provisions are provided for under Articles 3, 4, 5, 8, 9, 10, 11, 12, 13, 14, 15, 17, 18-26, and part of Articles 6 and 7. A Party to the Multilateral Instrument can choose whether or not the optional provisions should be applied to its Covered CDTAs.

principal purpose test ("PPT")[6] to address situations of treaty abuse, including certain conduit financing arrangements. As the PPT is considered less restrictive than the limitation on benefits ("LOB") rule[7] and is the only approach that can satisfy the minimum standard on its own, there will be minimal impact on Hong Kong taxpayers;

(c) Article 16 (Mutual Agreement Procedure) improves the dispute resolution mechanism by incorporating into Covered CDTAs certain provisions to ensure that access to mutual agreement procedure ("MAP")[8] is available, and that MAP cases are resolved within a reasonable timeframe and implemented quickly. In particular, taxpayers may present their cases to the competent authorities of either contracting parties to a Covered CDTA instead of their own residence jurisdiction or, where the CDTA partner has opted for an alternative rule, a bilateral notification or consultation process between the competent authorities of the contracting parties will be implemented. The enhanced mechanism will facilitate effective and efficient resolution of cross-border tax disputes and is to the benefit of Hong Kong taxpayers; and

(d) the optional provision under Article 6 will include in the Covered CDTAs a preamble text which refers to a desire to further develop economic relationship and enhance co-operation in tax matters with the CDTA partners.

7. The OECD has been monitoring on an annual basis Hong Kong's progress in implementing the minimum standards of the BEPS package, covering both the availability of the necessary legal framework and the effectiveness of implementation. It is therefore imperative for Hong Kong

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6 PPT provides that a taxpayer shall not be granted a tax treaty benefit if obtaining that benefit is one of the principal purposes of any arrangement or transaction involved.

7 LOB provides that a taxpayer shall not be entitled to a tax treaty benefit unless it constitutes a "qualified person" by reference to various attributes, or the taxpayer falls within the exceptions based on the taxpayer's active conduct of a business in its resident jurisdiction, the ownership of the taxpayer or the purposes for which the taxpayer is established, acquired or maintained or its operations are conducted.

8 MAP provides a dispute resolution mechanism, independent from the ordinary legal remedies available under the internal law, through which the competent authorities of the contracting parties to a CDTA may resolve differences or difficulties regarding the interpretation or application of the CDTA on a mutually-agreed basis.

to give effect to the Multilateral Instrument in a timely manner after the CPG has deposited the instrument of approval with the OECD so as to ensure that our CDTAs are BEPS-compliant, fulfil Hong Kong's international tax obligations and avoid the risk of Hong Kong being considered as an uncooperative tax jurisdiction.

8. A gist of the key provisions of the Multilateral Instrument and Hong
B Kong's position on such provisions is set out in **Annex B**.

9. Hong Kong has so far signed CDTAs with 45 jurisdictions[9]. 39 of our existing CDTAs (and any amending or accompanying instruments thereto)[10] are listed as agreements that Hong Kong wishes to be covered by the Multilateral Instrument. The number of CDTAs eventually to be covered and modified by the Multilateral Instrument will depend on whether our CDTA partners also participate in the Multilateral Instrument and list their CDTAs with Hong Kong as agreements that they wish to be covered by the Multilateral Instrument such that they become Covered CDTAs. As regards CDTAs to be signed in future, we will incorporate the relevant provisions to implement the treaty-related minimum standards of the BEPS package in those CDTAs.

10. The extent to which the application of a Covered CDTA will be modified by the Multilateral Instrument depends on the matching of the reservations and notifications applicable to Hong Kong and the CDTA partner. Since Hong Kong has adopted only the mandatory provisions of the Multilateral Instrument (save for an optional provision under Article 6), other optional provisions will not apply to the Covered CDTAs.

11. After the completion of the necessary legislative and administrative procedures, the Multilateral Instrument will apply alongside the Covered CDTAs and modify their application. The timing of entry into effect of the modifications to a Covered CDTA will depend on the completion of

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[9] The CDTAs have been given effect in Hong Kong by subsidiary legislation made under section 49(1A) of the IRO.

[10] Six of Hong Kong's CDTAs that are not listed as agreements that Hong Kong wishes to be covered by the Multilateral Instrument are the CDTAs with the Mainland, the Macao Special Administrative Region, Estonia, Finland, Georgia and Serbia. All of them have already contained BEPS-compliant provisions.

procedures for ratifying the Multilateral Instrument in the other relevant contracting jurisdictions. To facilitate stakeholders' understanding of the effect of the Multilateral Instrument on individual CDTAs of Hong Kong, the Inland Revenue Department ("IRD") will update its website from time to time to provide information as to when the relevant provisions of the Multilateral Instrument will come into effect in respect of the Covered CDTA and the extent to which the CDTA concerned will be modified.

OTHER OPTIONS

12. An order made by the CE-in-C under section 49(1A) of the IRO is the only way to give effect to the Multilateral Instrument. There is no other viable option.

THE ORDER

13. Under section 49(1A) of the IRO, if the CE-in-C by order declares that arrangements specified in the order have been made with the government of any territory outside Hong Kong for certain purposes, and that it is expedient that those arrangements should have effect, those arrangements shall have effect. The Order, at **Annex A**, sets out the full text of the Multilateral Instrument as well as the reservations and notifications applicable to Hong Kong made under the Multilateral Instrument by the CPG. The Order is subject to negative vetting by the Legislative Council ("LegCo"). The main provisions of the Order are as follows –

(a) **Section 3** contains the declarations, for the purposes of section 49(1A) of the IRO, so that the arrangements specified in section 4 shall have effect;

(b) **Section 4** specifies the arrangements for the purposes of section 3, namely, the arrangements in: (i) the Multilateral Instrument; and (ii) the reservations and notifications applicable to Hong Kong made under the Multilateral Instrument by the CPG;

(c) **Schedule 1** sets out the text of the Multilateral Instrument[11]; and

(d) **Schedule 2** sets out the reservations and notifications applicable to Hong Kong made under the Multilateral Instrument by the CPG[12].

LEGISLATIVE TIMETABLE

14. The legislative timetable is as follows –

Publication in the Gazette	30 September 2022
Tabling at LegCo	19 October 2022
Commencement of the Order	9 December 2022

IMPLICATIONS OF THE PROPOSAL

15. 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 or productivity implications, and no sustainability implications other than those set out in
C the economic implications paragraph in **Annex C**. The economic, financial and civil service implications of the proposal are set out in **Annex C**.

PUBLIC CONSULTATION

16. The Government conducted a consultation exercise in 2016 on the proposed implementation strategy for the BEPS package in Hong Kong. Respondents generally expressed support for the proposal to modify the application of Hong Kong's CDTAs by way of the Multilateral Instrument (as opposed to bilateral negotiations). We also briefed the LegCo Panel on Financial Affairs at its meeting on 5 March 2018 on the proposed

[11] The Order contains a reproduction of the English text of the Multilateral Instrument and a Chinese translation thereof.

[12] The Order contains a reproduction of the English text of the list of reservations and notifications and a Chinese translation thereof.

application of the Multilateral Instrument to Hong Kong and Members raised no objection.

PUBLICITY

17. We will issue a press release before tabling the Order at the LegCo. A spokesperson will be available to answer enquiries. We will also inform the relevant professional and trade bodies of the extension of the application of the Multilateral Instrument to Hong Kong.

BACKGROUND

18. The OECD released a package of 15 actions in October 2015 to counter BEPS. Out of the 15 actions, four are minimum standards, namely imposing country-by-country reporting requirements, improving the cross-border dispute resolution mechanism, countering harmful tax practices and preventing treaty abuse.

19. In June 2016, Hong Kong indicated to the OECD its commitment to implementing the BEPS package. The Inland Revenue (Amendment) (No. 6) Ordinance 2018 was subsequently enacted in July 2018 to codify the transfer pricing principles into the IRO and implement the minimum standards under the BEPS package as mentioned in paragraph 18 except for those tax treaty-related requirements.

20. As at November 2021, 141 jurisdictions committed to implementing the BEPS package.

ENQUIRIES

21. In case of enquiries about this Brief, please contact Mr Stephen Lo, Principal Assistant Secretary for Financial Services and the Treasury (Treasury), at 2810 2317.

Financial Services and the Treasury Bureau
28 September 2022