

# Hong Kong

## Recent Developments in Hong Kong's Exchange of Information Rules

Alfred Chan<sup>[1]</sup>

Issue: Asia-Pacific Tax Bulletin, 2016 (Volume 22), No. 6

Published online: 15 December 2016

In this article, the author discusses the 2010, 2013 and 2016 amendments to Hong Kong's Inland Revenue Ordinance, to bring Hong Kong into line with the OECD's international standards on exchange of information. The author outlines the objectives of the amendments and comments on the changes made in each of those years.

### 1. Introduction

At the London G20 summit in 2009, the government of the Hong Kong special administrative region (the Hong Kong SAR government) of the People's Republic of China was found not to have put in place a legal framework for transparency and exchange of tax information which is in compliance with internationally agreed standards.

The internationally agreed tax standards serve as a model for the vast majority of the bilateral double tax agreements (DTAs) entered into by OECD and non-OECD countries, and are the international norm for tax co-operation. The standards require:

- exchange of information on request where it is “foreseeably relevant” to the administration and enforcement of the domestic laws of the treaty partner;
- that there are no restrictions on exchange of information (EOI) caused by bank secrecy or by the requirements of domestic taxation interests;<sup>[1]</sup>
- availability of reliable information and powers to obtain it;
- respect for taxpayers' rights; and
- strict confidentiality of information exchanged.<sup>[2]</sup>

The absence of an internationally acceptable EOI framework meant that Hong Kong was enabling residents of other jurisdictions to evade taxes imposed by their home countries, and that posed an imminent threat to Hong Kong's position as an international finance centre.

At the close of the London G20 summit, China was included in the list of jurisdictions that had substantially implemented the internationally agreed tax standard (i.e. it was on the “white list”),<sup>[3]</sup> only to find that the Hong Kong special administrative region (and the Macau special administrative region) was excluded. Hong Kong needed to make a commitment to address the deficiency after the conclusion of the summit.<sup>[4]</sup> To turn the commitment into action, the Hong Kong SAR government has since made several changes to the Inland Revenue Ordinance (the IRO) to comply with international standards.<sup>[5]</sup>

This article focuses on the amendments that have been made to the IRO since 2009, the differences between the changes, and how the changes affect the relationship between:

- Hong Kong and other jurisdictions; and
- the Hong Kong Inland Revenue Department (the IRD) and parties that are obliged to provide information, including financial institutions, which are obliged to collect and report specified information required for EOI purposes and account holders who supply the information to the reporting financial institution.

---

\* Dr. Alfred Chan is licensed to practice as a CPA in Hong Kong and is director of China Tax & Investment Consultants Ltd. He may be contacted at [alfredchan@kkchan-cpa.com.hk](mailto:alfredchan@kkchan-cpa.com.hk).

1. I.e. the IRD's powers under the IRO to access information pursuant to an EOI request are limited to there being a domestic tax interest in Hong Kong.

2. See <http://www.oecd.org/tax/transparency/frequentlyaskedquestions.htm#whatintagreedtaxstandard>.

3. See <https://www.oecd.org/ctp/42497950.pdf>.

4. See D. Lesage, *The G20 and Tax Havens: Maintaining the Momentum?* Universiteit Gent, 2010, p. 4, available at <http://www.g20.utoronto.ca/biblio/lesage-tax-havens.pdf>.

5. Other ordinances were also amended (such as the Personal Data (Privacy) Ordinance), which are relevant to the achievement of the objectives of the commitments.

## 2. Objectives of Amendments

According to the objectives Hong Kong wishes to achieve, the amendments to the IRO can be broken down into the following sub-objectives:

- (1) Authorizing the Hong Kong SAR government to conclude DTAs and tax information exchange agreements (TIEAs) with other jurisdictions;
- (2) Removing domestic tax interest requirements from the IRO;<sup>[6]</sup>
- (3) Enabling the IRD to have access, and the power to gain access, to the information required for purpose of EOI;
- (4) Imposing penalties on persons who have the obligation to provide, or assist in the provision of, tax information, but fail to do so; and
- (5) Providing for the Hong Kong SAR government to sign competent authority agreements (CAAs) with other jurisdictions.

Depending on their nature, the amendments to the IRO can be classified as changes to substantive law or changes to procedural law.<sup>[7]</sup>

The sub-objectives under (1) and (2) above fall under changes to substantive legal rules, meaning that the amendments deal with the relationship between Hong Kong and other jurisdictions, and between the IRD and persons holding information, including financial institutions and account holders. Sub-objective (4) affects the obligations on persons that hold information, by imposing sanctions in case of non-compliance.

Sub-objectives (3) and (5) fall under amendments to the procedural rules. Sub-objective (3) ensures due process by laying down detailed steps for the person who owes the legal obligations to act and the steps the IRD must take, while sub-objective (5) gives effect to EOI with tax authorities of other jurisdictions.

## 3. Analysis of Amendments

### 3.1. 2010 Amendments to the IRO

Section 49(1A) was added to the IRO. Section 49(1A) states:

If the Chief Executive in Council by order declares that arrangements specified in the order have been made with the government of any territory outside Hong Kong, and that it is expedient that those arrangements should have effect, those arrangements shall have effect and, in particular—

- (a) shall have effect in relation to tax under this Ordinance despite anything in any enactment; and
- (b) for the purposes of any provision of those arrangements that requires disclosure of information concerning tax of that territory, shall have effect in relation to any tax of that territory that is the subject of that provision.

The order made by the Chief Executive in Council is a piece of subsidiary legislation, and it will become law after negative vetting by Hong Kong's legislative body.<sup>[8]</sup> The 2010 amendment, for the first time, enables Hong Kong to sign DTAs with its trading partners under the framework of the OECD model DTA and extends the IRD's powers beyond those required only to administer Hong Kong's domestic tax law.

---

6. Section 14 of the IRO provides that "profits tax shall be charged ... on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong ... from such trade, profession or business (excluding profits arising from the sale of capital assets) ...". Thus, the IRO does not impose tax on foreign income, nor does it impose tax on capital gains. However, the amendments to the IRO in 2010 expanded the IRD's power to collect and disclose tax information in response to requests made by Hong Kong's treaty partners for their own tax purposes; for example, information about a United Kingdom resident relating to the capital gain arising from the disposal of shares in a Hong Kong company, notwithstanding that capital gains are not taxable in Hong Kong.

7. Procedural laws are enacted in order to give effect to the substantive laws.

8. Nearly all subsidiary legislation is subject to the scrutiny of, or approval by, the Legislative Council. The positive and negative vetting procedures are the two alternative procedures under which subsidiary legislation may be scrutinized or approved by the Council. Under the negative vetting procedure, subsidiary legislation is laid before the Legislative Council at its first sitting after the legislation is published in the *Gazette*. Not later than 28 days after that sitting, the Council may amend the subsidiary legislation by resolution at a Council meeting. By passing a resolution, the Legislative Council may also extend the scrutiny period by 21 days, or to the first Council meeting held after the 21st day from the original expiry date. Unless another date is provided, the subsidiary legislation commences on the date of its publication in the *Gazette*.

The IRD's power to gather information has expanded to collect information in response to requests made by Hong Kong's treaty partners for their own tax purposes. Section 51(4AA) was added to the IRO to enable an IRD assessor to exercise the same power as under section 51(4) of the IRO in order to collect information concerning tax of a territory outside Hong Kong for the purpose of EOI.<sup>[9]</sup>

Section 51B(1AA) was also added to the IRO, which enables a magistrate to exercise the same power under section 51B of the IRO to issue search warrants for information concerning tax of a territory outside Hong Kong for the purpose of EOI.<sup>[10]</sup>

To enforce the IRD's power to obtain the requested information, section 51B(4) provides that:

[a]ny person who obstructs or hinders the Commissioner or an authorized officer acting in the discharge of his duty under subsection (1) ... commits an offence and is liable on conviction to a fine at level 3 [HKD 10,000] and imprisonment for 6 months.

These expanded powers are more than necessary for the IRD to administer and enforce Hong Kong's domestic tax rules, but are necessary to discharge its obligations as the requested jurisdiction under paragraphs 4 and 5 of Article 26 (Exchange of Information) in the OECD model DTA.

### 3.2. 2013 Amendments to the IRO

In 2013, section 49(1B) was added to the IRO, and restricts the Hong Kong SAR government to make arrangements for the following two specified purposes:

- (a) affording relief from double taxation;
- (b) exchanging information in relation to any tax imposed by the laws of Hong Kong or the territory concerned.

In respect of returns and information to be furnished to the IRD, section 51(4)(a) of the IRO was amended as follows:

- 
9. Subsection 4 of section 51 of the IRO provides that:  
"For the purposes of obtaining full information in regard to any matter which may affect any liability, responsibility or obligation of any person under this Ordinance—
- (a) an assessor or an inspector may give notice in writing to such person, or to any other person whom he considers may be in possession or control of information or documents in regard to any such matter as aforesaid, requiring him within such reasonable time as is stated in the notice, ... to furnish all information in his possession or control respecting any such matter, and to produce for examination any deeds, plans, instruments, books, accounts, trade lists, stock lists, vouchers, bank statements or other documents which the assessor or inspector giving the notice considers are or may be relevant for the purpose aforesaid ... ;
  - (b) an assistant commissioner may give notice in writing to such person, or to such other person, requiring him, at a time and place to be named by the assistant commissioner, to attend and be examined, and upon such examination to answer truthfully all questions put to him, respecting any such matter as aforesaid."
10. Section 51B(1) provides that:  
"If the Commissioner, or an officer of the Inland Revenue Department not below the rank of chief assessor authorized in writing by the Commissioner for the purpose (in this section referred to as the authorized officer), satisfies a magistrate, by statement made on oath,—
- (a) that there are reasonable grounds for suspecting that a person has made an incorrect return or supplied false information having the effect of understating his income or profits chargeable to tax and has done so without reasonable excuse and not through an innocent oversight or omission; or
  - (b) that a person has failed to comply with an order of a court made under section 80(1) or (2A) directing him to comply with the requirements of a notice given to him under section 51(1) or (3),
- the magistrate may by warrant authorize the Commissioner or authorized officer to exercise the following powers—
- (i) without previous notice at any reasonable time during the day, to enter and have free access to any land, buildings, or place where he suspects there to be any books, records, accounts or documents of that person, or of any other person, which may afford evidence material in assessing the liability of the first-mentioned person for tax, and there to search for and examine any books, records, accounts or documents;
  - (ii) in carrying out any such search, to open or cause to be removed and opened, any article in which he suspects any books, records, accounts or documents to be contained;
  - (iii) to take possession of any books, records, accounts or documents of that person or that person's spouse, and to make copies of such parts of any books, records, accounts or documents of any other person, as may afford evidence material in assessing the liability of the first-mentioned person for tax;
  - (iv) to retain any such books, records, accounts or documents for as long as they may be reasonably required for any assessment to be made or for any proceedings under this Ordinance to be completed:
- Provided that if the Commissioner or authorized officer shall retain any book, record, account or document for a period of more than 14 days, the person aggrieved may apply in writing to the Board of Review for an order directing the return thereof and the Board of Review, after hearing the applicant or his authorized representative and the Commissioner or his representative, may so order, either unconditionally or subject to any condition which the Board may consider it proper to impose."

an assessor or an inspector [of the IRD] may give notice in writing to ... any ... person whom he considers may be in possession or control of information or documents ... .

Similarly, section 51(4A)(i) was also amended to expand the IRD's power of access to information, by adding the phrase "or control" was added immediately after the words "in possession".

Consequent upon the 2013 amendment, the Hong Kong SAR government signed several TIEAs with other countries.<sup>[11]</sup> In addition, the number of DTAs that Hong Kong entered into with other jurisdictions increased significantly after the 2013 amendment (from 3 in 2010 to 34 at the end of 2015). Furthermore, the new DTAs were concluded in accordance with the latest version of the OECD Model DTA.<sup>[12]</sup>

### 3.3. 2016 Amendment to the IRO

#### 3.3.1. Background to the 2016 amendment

The 2016 Inland Revenue (Amendment) (No. 3) Ordinance became effective on 30 June 2016, with the objective of implementing automatic exchange of information (AEOI), in compliance with the Common Reporting Standard (CRS).

The CRS was developed in response to a G20 request and was approved by the OECD Council on 15 July 2014. It calls on jurisdictions to obtain information from their financial institutions and automatically exchange that information with other jurisdictions on an annual basis.

The CRS consists of the following four key parts:

- (1) a model CAA, providing the international legal framework for AEOI;
- (2) the actual standard;
- (3) Commentaries on the CAA and the CRS; and
- (4) the CRS XML Schema User Guide.<sup>[13]</sup>

The 2016 amendment to the IRO covers three aspects. It ensures that:

- the required tax information is available;
- the IRD has access, and has the legal power to gain access, to the tax information; and
- legal arrangements are in place for tax information to be exchanged with jurisdictions with which Hong Kong has concluded DTAs.

#### 3.3.2. Legal obligations on the reporting financial institution

Sections 50B(1) and 50B(2) of the IRO impose several legal obligations on a reporting financial institution, viz.:

- (1) A reporting financial institution<sup>[14]</sup> must–
  - (a) establish procedures that are designed to–
    - (i) identify the jurisdiction of residence of–
      - (A) the account holder of a financial account maintained with the institution; and

---

11. A TIEA was signed with the United States on 25 March 2014 and TIEAs were signed with the six Nordic countries (Denmark, Faroes, Greenland, Iceland, Norway and Sweden) on 22 August 2014.

12. The domestic tax interest element has not yet been removed from DTAs concluded before 2010, i.e. with Belgium, Thailand and Vietnam. However, in June 2013 Hong Kong received Vietnam's agreement to update the EOI article in line with the OECD model DTA article 26, and is arranging the signing of a protocol accordingly: see OECD, *Global Forum on Transparency and Exchange of Information for Tax Purposes Peer Review: Hong Kong, China 2013, Phase 2: Implementation of the Standard in Practice*, para. 343.

13. See <http://www.oecd.org/tax/automatic-exchange/common-reporting-standard/>.

14. "Reporting financial institution" means–

- (a) a financial institution that is resident in Hong Kong (excluding any branch of the financial institution located outside Hong Kong); or
- (b) a branch located in Hong Kong of a financial institution that is not resident in Hong Kong, but does not include a non-reporting financial institution.

"Non-reporting financial institution" means a financial institution that is described as a non-reporting financial institution in Part 2 of Schedule 17C, and includes a government entity, international organization, central bank, the Hong Kong Monetary Authority, a pension fund of a government entity, international organization, central bank or Hong Kong Monetary Authority, a participation retirement fund, qualified credit card issuer, exempt collective investment vehicle, trustee-documented trust, granted and subsidized school provident funds, a mandatory provident fund scheme, occupational retirement scheme and credit union.

- (B) (if the account holder is a passive NFE) the controlling person of the passive NFE;<sup>[15]</sup>
- (ii) identify whether a financial account is a reportable account;<sup>[16]</sup>
- (iii) secure that any evidence relied on, or a record of the steps taken, for carrying out the procedures in relation to a financial account is kept for a period of 6 years beginning on the date on which the procedures are completed; and
- (iv) enable the institution to identify and collect the required information ... ; and
- (b) incorporate into those procedures the due diligence requirements ... .
- (2) A reporting financial institution must maintain and, for carrying out its obligations ... , apply the procedures established in compliance with subsection (1)(a) and (b) (required procedures)–
  - (a) to identify reportable accounts, and to identify and collect the required information; and
  - (b) to ensure that the purpose mentioned in subsection (1)(a)(iii) can be achieved.

### 3.3.3. Mandatory vs. voluntary reporting requirements

To comply with sections 50B(1) and (2), a reporting financial institution *must* establish, maintain and apply due diligence procedures to identify account holders (including controlling persons of the accounts) who are tax residents of a reportable jurisdiction.

Pursuant to section 50B(3), the financial institution is also *at liberty to* apply due diligence procedures to any financial account, the account holder of which is a tax resident of a jurisdiction with which Hong Kong has not concluded a DTA (i.e. a non-reportable jurisdiction). If Hong Kong later signs a DTA with a previously non-reportable jurisdiction, some of the financial accounts may become reportable accounts. In that case, the voluntary reporting requirement may become a mandatory one.

## 4. General Comments

Neither the 2010 or 2013 amendment imposes obligations on a person to whom an EOI clause in a DTA applies, beyond the requirement to keep records of business transactions. The 2016 amendment introduces additional requirements on a reporting financial institution

---

15. "NFE" means an entity that is not a financial institution.

16. "Reportable account"–

(a) means a financial account–

(i) that has been identified as such under the due diligence requirements in Schedule 17D of the IRO; and

(ii) that is held by–

(A) at least one reportable person; or

(B) a passive NFE with at least one controlling person being a reportable person; and

(b) for the purposes of sections 50C, 50D, 50F and 50G of the IRO, includes a pre-existing account that must be reported as an undocumented account under the due diligence requirements in Schedule 17D.

"Reportable person"–

(a) means–

(i) an individual or entity that is a resident for tax purposes of a reportable jurisdiction; or

(ii) an estate of a decedent who was a resident for tax purposes of a reportable jurisdiction; but

(b) does not include–

(i) a corporation the stock of which is regularly traded on an established securities market;

(ii) a corporation that is a related entity of a corporation mentioned in subparagraph (i);

(iii) a governmental entity;

(iv) an international organization;

(v) a central bank; or

(vi) a financial institution.

"Reportable jurisdiction" means a territory outside Hong Kong–

(a) that is a party to an arrangement having effect under section 49(1A) of the IRO and requiring disclosure of information concerning tax of the territory; and

(b) that is specified in column 1 of Part 1 of Schedule 17E of the IRO.

to keep the information defined in section 50B of the IRO. Superseding the 2010 amendment, the 2013 amendment permits the IRD to exchange information relating to the administration or enforcement of the tax laws of an EOI treaty partner in respect of any period that starts after the EOI arrangement came into operation, even if that information pre-dates that period.<sup>[17]</sup>

The scope of information to be exchanged under an exchange of information request (EOIR) – introduced in the 2013 amendment – is not the same as that under AEOL (introduced in the 2016 amendment). But there are overlaps between the two. For example, the tax authority of a Hong Kong partner jurisdiction may request the IRD to provide pricing information of a Hong Kong company, which is foreseeably relevant to the performance by the tax authority of that requesting jurisdiction of a transfer pricing audit on comparable uncontrolled prices, even if the controlling person or beneficial owner of the Hong Kong company is not a tax resident of that jurisdiction. However, the pricing information does not fall within the scope of AEOL. Likewise, the requirement on the reporting financial institution to identify and collect information required under section 50B(1) of the IRO (i.e. tax residence of the account holder) is not provided for under the EOIR framework. The required information will only be exchanged with the jurisdiction of which the account holder is a tax resident, under the AEOL framework.

The 2016 amendment is an important step taken to ensure that Hong Kong has established a legal and regulatory framework in compliance with internationally agreed standards, developed by the OECD. All three amendments to the IRO mean that, first, Hong Kong now stands ready for the third round of peer review by the Global Forum under the 2016 terms of reference on EOIR<sup>[18]</sup> and, second, it has finally put in place the legal and regulatory framework for AEOL, which is in compliance with the CRS, and stands ready to enter CAAs with partner jurisdictions for AEOL purposes.<sup>[19]</sup>

---

17. OECD, *supra* n. 12, para. 61.

18. Hong Kong has undergone the Phase 1 and Phase 2 peer reviews of its legal framework and implementation of the standards for tax transparency, both with a rating of “largely compliant”: see OECD, *Tax Transparency 2015*, p. 15.

19. Section 50J of the IRO provides that the Secretary for Financial Services and the Treasury may, by notice published in the *Gazette*, amend Schedules 17C, 17D, or 17E. The names of the participating jurisdictions are expected to be released as Schedule 17E of the IRO before the end of 2017.