

Recent Development of Hong Kong's EOI Regime

Introduction

At the London G20 summit back in 2009, the government of the Hong Kong special administrative region (the Hong Kong government) of the People of Republic of China was found not to have put in place a legal framework for transparency and exchange of tax information that is in compliance with the internationally agreed standard. The absence of such a legal framework meant that Hong Kong was enabling residents of other jurisdictions to evade the taxes imposed by their home countries, and that posed an imminent threat to Hong Kong's position as an international finance center.

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 (the white list),¹ only to find that Hong Kong special administrative region (Macau as well) was excluded, which needed to make commitment to address its deficiency after the conclusion of the G20 summit.² To turn the commitment into action, the Hong Kong government has since then made several changes to the Inland Revenue Ordinance (the IRO) in compliance with the internationally agreed tax standards.³

The scope of this article will focus on what changes or amendments have been made to the IRO since 2009, what differences between the changes are, and how these changes affect the relationship between Hong Kong and other jurisdictions, and that between the Hong Kong Inland Revenue Department (the IRD) and the obligors, including the financial institutions who are obligated to collect and report the information required for exchange of information (EOI) purposes and who supply the information to the reporting financial institution.

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 government to conclude double tax agreements (DTA) as well as tax information exchange agreements (TIEA) with other jurisdictions;
2. Removing the elements of domestic tax interests from the IRO;
3. Enabling the administrative authority has access, and the power to gain access, to the information required for purpose of exchange of tax information;
4. Imposing penalties on any person who owes the obligation to provide or assist in the provision of, the tax information, but fails to do so.

¹ <https://www.oecd.org/ctp/42497950.pdf>

² The G20 and Tax Havens: Maintaining the Momentum?, Prof. dr. Dries Lesage, p4.

³ Other ordinances are also amended (such as the Personal Data (Privacy) Ordinance) that are relevant to the achievement of the aforesaid objectives.

5. Providing for the HK government to sign competent authority agreement with other jurisdictions

According to the natures of the amendments to the IRO, the amendments can be broken down into a change in the substantive law and a change in the procedural law.

The sub-objectives itemized as 1 and 2 will fall under the change in substantive legal rules, meaning that the amendments deal with the relationship between Hong Kong and other jurisdictions, between the Hong Kong tax authority and the person, including the financial institution and the account holder. Item 4 affects the obligor's rights by imposing sanctions in case of non-compliance.

Sub-objectives item 3 and 5 will fall under the amendment to the procedural rules. Item 3 ensures the due process by laying down details steps for the person who owes the legal obligations to act and the steps the tax administrative must take, while item 5 gives effect to the exchange of information with the tax authority of other jurisdictions. The procedural laws are enacted in order to give effect to the substantive laws.

Analysis on amendments to the IRO

Amendments to the IRO (2010)

1. In response to the change in external financial environment, section 49(1A) was added to the Inland Revenue Ordinance:

"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."

2. 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. The 2010 amendment removes the provisions for domestic interest requirements and enables Hong Kong to sign double tax agreements with her trading partners under the framework of the OECD Model Tax Convention for the first time.

3. The 2010 amendment expanded the IRD's power to collection information in response to requests made by Hong Kong's treaty partners for their tax administration and enforcement purposes. Section 51(4AA) was added to the IRO, which enable an IRD assessor to exercise the same power as under section 51(4) of the IRO, in order to

collection information concerning tax of a territory outside Hong Kong for EOI purposes.⁴ Section 51B(1AA) was also enacted to enable the IRD to have the same power as under section 51B(1) for the same EOI purposes.⁵

4. The IRD's expanded powers are not required for it to administer and enforce Hong Kong's domestic tax rules, but they are needed to discharge Hong Kong's obligation under the DTA as the requested jurisdiction.

5. After the enactment of the 2010 amendment, the number of comprehensive double tax agreements Hong Kong has signed with other jurisdictions has increased from 3 in 2010 to 35 at the end of 2016. All these CDTA are concluded in line with the OECD model tax convention, with the exception for CDTA with Belgium, Vietnam and Thailand.

Amendments to the IRO (2013)

⁴ Section 51(4): 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, and in the form and manner specified in it, 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:

Provided that in the case of a notice under this paragraph requiring the production of any account kept by a solicitor and relating to the affairs of any client or clients of his, production of a copy of all relevant entries therein respecting any matter upon which information is sought shall be a sufficient compliance with the aforesaid requirement of the notice if the copy is certified by the solicitor as being a correct copy of all relevant entries in such account respecting the matter 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.

⁵ Section 51B(1): 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), (Amended 56 of 1993 s. 22)

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; (Amended 43 of 1975 s. 4)

(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; (Replaced 43 of 1975 s. 4. Amended 71 of 1983 s. 27)

(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. (Amended 7 of 1975 s. 34)

1. Section 49(IB) was added under which the Chief Executive in Council is empowered to allow the HKSAR government to make arrangements for the following two specified purposes:

(a) making arrangement with other jurisdiction in order to afford relief from double taxation;

(b) upon request, exchanging information in relation to any tax imposed by the laws of Hong Kong or territory concerned. That means the jurisdictions with which Hong Kong has concluded tax treaties.

2. In respect of returns and information to be furnished to Hong Kong tax authorities, section 51(4)(a) was amended as follows: "**an assessor or an inspector (of the IRD) may give notice in writing to such person, or any other person whom he consider may be in possession or control of information or documents ...**". Similarly, section 51(4A)(i) was also amended as under section 51(4)(a). It is noted that the IRD's power of access to information is expanded as the phrase "or control" was added immediately to the end of "in possession".

3. Consequent upon the 2013 amendment, the Hong Kong government signed several tax information exchange agreements (TIEA) with other countries.⁶

Amendment to the IRO (2016)

Background of the 2016 amendment

1. The 2016 Inland Revenue (Amendment) (No. 3) Ordinance became effective on 30th June 2016, with the objective to the implementation of automatic exchange of information ('AEOI') in compliance with the Common Reporting Standard ('CRS'). The 2016 amendment covers three aspects: the required tax information is available, the Hong Kong Inland Revenue Department (the IRD) has access, and has the legal power to gain access, to the tax information, and the legal arrangement is in place for tax information to be exchanged with jurisdictions with which Hong Kong has concluded CDTA's.

2. The Common Reporting Standard (CRS), developed in response to the G20 request and approved by the OECD Council on 15 July 2014, calls on jurisdictions to obtain information from their financial institutions and automatically exchange that information with other jurisdictions on an annual basis. The Standard consists of the following four key parts: (i) a model Competent Authority Agreement (CAA), providing the international legal framework for the automatic exchange of information; (ii) the Common Reporting Standard; (iii) the Commentaries on the CAA and the CRS; and (iv)

⁶ TIEA signed with the US on 25th March 2014; and TIEA's signed with the 6 other Nordic countries (Denmark, Faroes, Greenland, Iceland, Norway and Sweden) on 22nd August 2014.

the CRS XML Schema User Guide.⁷

Legal obligations for the reporting financial institution

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

- (1) A reporting financial institution must⁸ —**
 - (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**
 - (B) (if the account holder is a passive NFE) the controlling person of the passive NFE;⁹**
 - (ii) identify whether a financial account is a reportable account;¹⁰**
 - (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 within the meaning of section 50C(3) (required information); and**
 - (b) incorporate into those procedures the due diligence requirements in Schedule 17D.**

⁷ <http://www.oecd.org/tax/automatic-exchange/common-reporting-standard/>

⁸ 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.

⁹ Reportable jurisdiction means a territory outside Hong Kong—

- (a) that is a party to an arrangement having effect under section 49(1A) and requiring disclosure of information concerning tax of the territory; and
- (b) that is specified in column 1 of Part 1 of Schedule 17E;

¹⁰ Reportable account—

(a) means a financial account—

- (i) that has been identified as such under the due diligence requirements in Schedule 17D; 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, 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 markets;
- (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;

- (2) A reporting financial institution must maintain and, for carrying out its obligations under this Part, 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.**

Mandatory vs. voluntary reporting requirement

4. As per section 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 Hong Kong's treaty jurisdictions (reportable jurisdiction). As per section 50B(3), the financial institution is also at its liberty to apply the 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 any tax treaty (non-reportable jurisdiction). It should be noted that if Hong Kong later signs a DTA with this previous non-reportable jurisdiction, some of the financial accounts may become reportable accounts. Thus the voluntary reporting requirement may become a mandatory one.¹¹

General comments

Neither the 2010 or 2013 amendments do not impose obligation on a person to whom the EOI clause in a DTA applies beyond the requirement for keeping records of business transactions. The 2016 amendment introduces additional requirements on the reporting financial institution to keep information as defined under section 50B of the IRO. To supersede the 2010 amendment, the 2013 amendment permits the Hong Kong IRD to exchange information relating to the administration or enforcement of the tax laws of an EOI partner in respect of any period that starts after the EOI arrangement came into operation, even if that information pre-dates such period.¹²

There are overlapping between EOIR and AEOI. However, the scope of information to be exchanged under EOIR (as introduced in the 2013 amendment) is not the same as that under AEOI (as introduced in the 2016 amendment). The tax authority of a Hong Kong's partner jurisdiction may request the Hong Kong IRD to provide the pricing information of a Hong Kong company that is foreseeably relevant to the performance of a transfer price audit on comparable uncontrolled pricing by the tax authority of that requesting jurisdiction (the applicant state), even if the controlling person or the beneficial owner of the Hong Kong company is not a tax resident of the applicant state. The pricing information does not fall under the scope of AEOI. Likewise, the requirement for the reporting financial institution to identify and collect information as required under

¹¹ See detailed legal texts of the term "reportable jurisdiction" in other footnotes.

¹² Paragraph 61, 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" OECD

section 50B(1) of the IRO (i.e. tax residence of the account holder of a financial account maintained with a reporting financial institution) is not provided 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 AEOI framework.

The 2016 amendment is an important step taken to ensure that Hong Kong has established a legal and regulatory framework in compliance with the internationally agreed standard, as developed by the OECD.¹³ All the three amendments to the IRO mean that first, Hong Kong now stands ready for the third round of peer review by Global Forum under the 2016 terms of reference on exchange of information on request (EOIR);¹⁴ and second, it has finally put in place the legal framework for AEOI which is in compliance with the CRS, and stands ready for entering competent authority agreement (CAA) with partner jurisdictions for AEOI purposes.¹⁵

Dr. Alfred K K Chan
China Tax & Investment Consultants Ltd
alfred@china-tax.net;

¹³ The internationally agreed tax standards serve as a model for the vast majority of the bilateral tax conventions 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.
- No restrictions on exchange caused by bank secrecy or domestic tax interest requirements.
- Availability of reliable information and powers to obtain it.
- Respect for taxpayers' rights.
- Strict confidentiality of information exchanged.

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

¹⁴ Hong Kong has undergone phase 1 and phase 2 peer reviews on her legal framework and implementation of the standards for tax transparency, both with a rating of "largely compliant". See page 15 of "Tax Transparency 2015" by OECD.

¹⁵ The names of the reportable jurisdictions and participating jurisdictions are expected to be released by the Hong Kong authorities as under Schedule 17E of the IRO before the end of 2016. Hong Kong has signed competent authority agreements with Japan and the UK respectively. The two CAA will take effect on 2016-12-31.