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AN UPDATE ON HONG KONG'S EXCHANGE OF INFORMATION DEVELOPMENTS AND ENGAGING WITH BEPS

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AN UPDATE ON HONG KONG'S EXCHANGE OF INFORMATION DEVELOPMENTS AND ENGAGING WITH BEPS

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Abstract

The Hong Kong Special Administrative Region (HKSAR) implemented automatic exchange of information (AEOI) with the Inland Revenue (Amendment) (No. 3) Ordinance 2016 coming into effect on 30 June 2016. This development is the latest phase in the reform of the HKSAR's exchange of information capability. AEOI follows earlier legislative reform to permit the HKSAR to enter into tax information exchange agreements (TIEAs), and the signing of a Model 2 intergovernmental agreement (IGA) under the United States' (US's) Foreign Account Tax Compliance Act (FATCA). The HKSAR is also actively engaged in the G20/OECD's Base Erosion and Profit Shifting (BEPS) initiative, becoming an Associate member in order to facilitate implementation of the relevant BEPS Action Plans in both the HKSAR and internationally. This paper briefly reviews the historical developments in information exchange in the HKSAR, focussing on the implications of AOEI and BEPS developments, with some thoughts as to what the future may look like for businesses operating in the HKSAR.

1.0 Introduction and Background

The last three years have produced unprecedented advances in tax transparency and exchange of information in the Hong Kong Special Administrative Region (HKSAR). The Global Forum for Transparency and Exchange of Information for Tax Purposes (Global Forum)[1] released its Phase Two Peer Review Report on the HKSAR in November 2013.[2] This report signalled that the HKSAR was largely compliant with its domestic law and regulations with respect to facilitating tax

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[1] See further http://www.oecd.org/tax/transparency/.

[2] OECD (2013), *Global Forum for Transparency and Exchange of Information for Tax Purposes: Phase Two: Hong Kong, China 2013* (OECD, Paris).

transparency and exchange of information (in a pre-automatic exchange of information (AEOI) environment). Furthermore, following the enactment of the Inland Revenue (Amendment) (No 2) Ordinance 2013 (the Ordinance) on 10 July 2013, the HKSAR has been able to enter into tax information exchange agreements (TIEAs); most significantly, the first TIEA was with the United States (US). Six further TIEAs were signed in August 2014 with: Denmark; Faroes Islands; Greenland; Iceland; Norway; and Sweden.[3]

Another significant event for the HKSAR was concluding an in substance Model 2 intergovernmental agreement (IGA) under the US's Foreign Account Tax Compliance Act (FATCA) which took effect in time for the 1 July 2014 implementation date of FATCA.[4] This was followed up by the HKSAR signing a final Model 2 IGA later in 2014. The writer would argue that the influence of the People's Republic of China (PRC) is clear with respect to the decision by the HKSAR to negotiate an IGA under FATCA, and to maintain ongoing negotiations to modify its comprehensive double tax agreement (CDTA) with the People's Republic of China (PRC). TIEAs and CDTAs have continued to be negotiated by the HKSAR.

Recently, the HKSAR spent a short period on the European Union's (EU's) blacklist of third country non-cooperative tax jurisdictions.[5] Conclusion of the Model 2 IGA would have assisted the HKSAR in being removed from the EU's blacklist of non-cooperative jurisdictions in October 2015.

In relation to the OECD's Base Erosion Profit Shifting (BEPS) Action Plans, the HKSAR has been a follower, and determined that, following a period of consultation, it will put in place an AEOI facility. An Amendment Bill was introduced in early 2016 for consideration by the Legislative Council (LegCo), which subsequently became law as from 30 June 2016. This paper will focus on the AEOI developments in the HKSAR. With respect to the wider BEPS initiatives, the HKSAR announced on 20 June 2016 that it would be fully embracing implementation of BEPS when it became an Associate member. This requires the HKSAR to review its current state of preparedness to meet BEPS expectations.

The remainder of this paper is organised as follows. The next section provides a brief overview of recent international developments and their potential implications with respect to AEOI in the HKSAR. Section 3 then overviews other developments in the international tax area, focussing on the

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[3] See http://www.ird.gov.hk/eng/tax/dta_tiea_agreement.htm. Negotiations are underway for a concluding a TIEA with Argentina, the Philippines and Poland.

[4] Pub. L. No. 111-147, 124 Stat 71 (March 18, 2010). FATCA comprises sections 1471 to 1474 of the Internal Revenue Code 1986.

[5] Financial Services and Treasury Bureau (FSTB), "Press Release: Hong Kong's tax co-operation status clarified by EC" (October 14, 2015), available at: http://www.fstb.gov.hk/tb/en/docs/pr_20151014_e.pdf.

HKSAR's engagement in the BEPS implementation process, before section 4 sets out the concluding observations from the earlier discussion.

2.0 Developments in automatic exchange of information in the HKSAR

In late 2014, the HKSAR Government indicated to the Global Forum that it intended to support the new standard of AEOI. The Panel on Financial Affairs (Panel) reported to LegCo that Panel members had exchanged views with the HKSAR Administration on a number of issues including:[6]

- the benefits of AEOI and compliance costs,
- consistency of reporting standard for local and overseas financial institutions, and
- safeguards to protect privacy and confidentiality of information exchanged.

As a consequence of the increasing aspirations of the international community for AEOI (reflected in more than 90 Global Forum members at that time expressing their commitment to AEOI), it was considered necessary for the HKSAR to put in place the required legal framework to enable AEOI. The risk of not doing so was that the HKSAR could be labelled as an uncooperative jurisdiction or a 'tax haven'. Such a label would undermine its position and competitiveness as an international business and financial centre.

Moving both sideways and forward to mid-2015, the European Union (EU) placed the HKSAR on its blacklist of 30 non-cooperative jurisdictions. This list included many of the well-known tax havens which is largely unsurprising. Soon after the release of the blacklist, the HKSAR Government expressed its regret over this decision by the EU, pointing out how the HKSAR has been cooperative and supportive of international efforts on EOI and transparency. Subsequently, on 14 October 2015, the HKSAR Government was able to advise that the EU had removed the HKSAR from its blacklist, although some member EU states retained the HKSAR on their own blacklists. In particular, the HKSAR's Financial Services and Treasury Bureau (FSTB) acknowledged that:[7]

> "The Government would like to express its gratitude to many stakeholders in the business community for their assistance in helping refute the unfounded allegation against Hong Kong as a tax haven, and in putting across a correct message on Hong Kong's position on tax co-operation."

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[6] Legislative Council, *Report of the Panel on Financial Affairs for submission to the Legislative Council* (November 2014), LC paper No. CB(1)000/14-15; available at: http://www.legco.gov.hk/yr14-15/english/panels/fa/reports/fa20150624cb1-999-e.pdf.

[7] See note 5.

Big four accounting firm PWC commented that the HKSAR will maintain an ongoing dialogue with the EU over it efforts regarding cooperation, will continue with drafting its response to AEOI, and continue to expand its network of CDTAs.[8]

Returning now to the matter of AEOI. On 24 April 2014 the HKSAR Government launched its consultation process on AEOI with the release of a comprehensive consultative document. This followed a brief period of engaging with stakeholders in the financial industry to assess their initial views on how AEOI should be implemented in the HKSAR. Professor K C Chan, the Secretary for the FSTB, stated in his media release:[9]

> "Hong Kong will adopt a *pragmatic approach to legislate for all essential requirements of the OECD standard on AEOI,* and will ensure effective implementation of the new standard. … Our plan is to *conduct AEOI on a bilateral basis with jurisdictions with which Hong Kong has signed a comprehensive avoidance of double taxation agreement (CDTA) or a Tax Information Exchange Agreement (TIEA).* In identifying AEOI partners from amongst our CDTA or TIEA partners, we will take into account their capability in meeting the OECD standard and in protecting data privacy and confidentiality of the information exchanged in their domestic law."

Annex C to the consultation document set out the proposed (and subsequently enacted) framework for AEOI in the HKSAR. It is reproduced on the next page:[10]

[8] PWC, "Applause for Hong Kong's removal from the EU's blacklist" (2015) *Hong Kong Tax* No 9 (October).

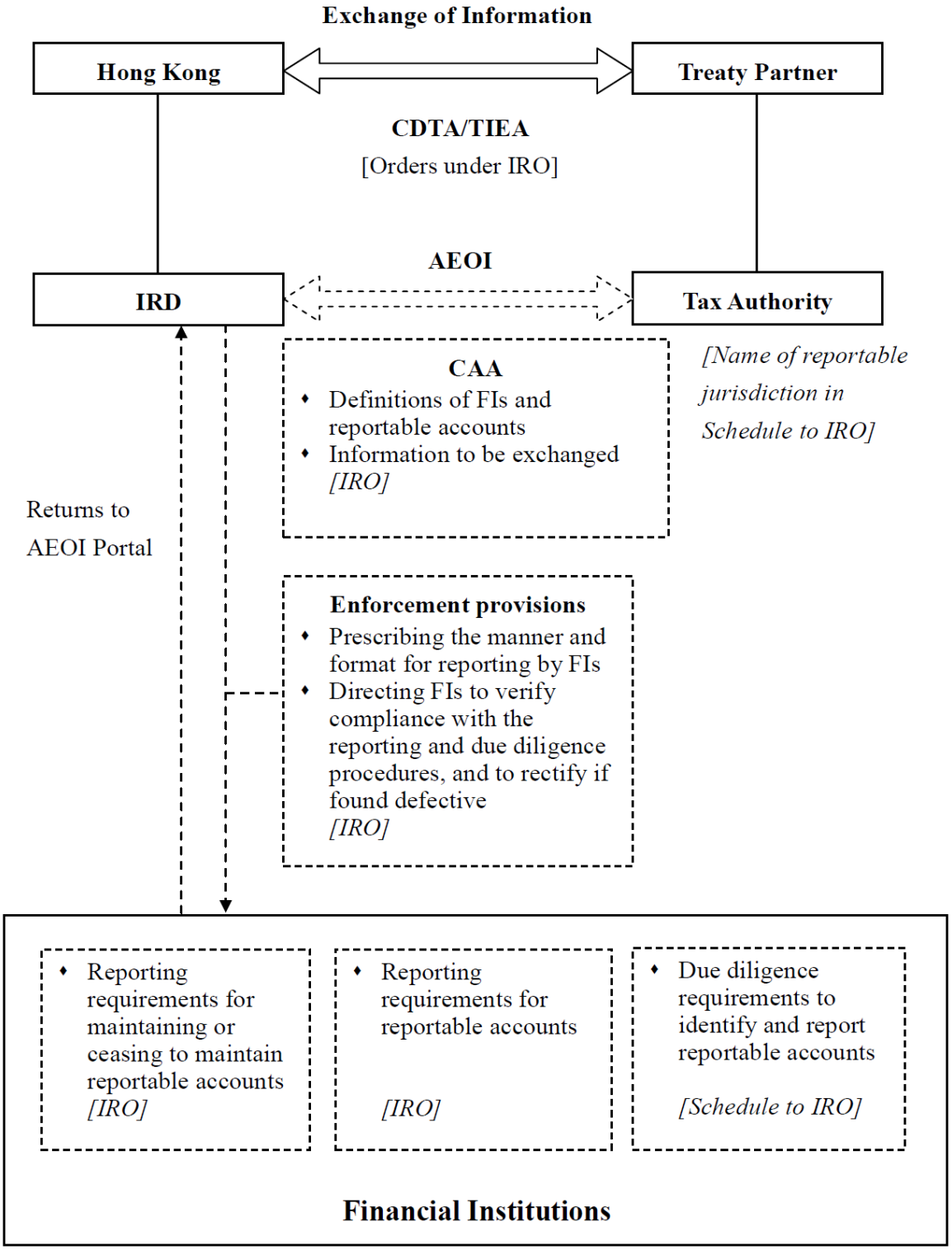
[9] Inland Revenue Department (HK), "Consultation on Automatic Exchange of Financial Account Information in Tax Matters in HK launched" (April 24, 2014); available at: http://www.ird.gov.hk/eng/ppr/archives/15042401.htm. The consultation document is available at: http://www.fstb.gov.hk/tb/en/docs/AEOI-ConsultationPaper-e.pdf.

[10] See Financial Services and the Treasury Bureau, *Consultation Paper on Automatic Exchange of Financial Information in Tax Matters in Hong Kong* (April 2015), at 62.

Figure 1: Framework for AEOI in the HKSAR

Annex C

Schematic Framework for AEOI Legislation in Hong Kong



The AEOI standard developed by the OECD and the Global Forum was heavily influenced by the US's FATCA approach. As a result, Big Four accounting firm EY observes:[11]

> "… financial institutions are expected to be able to leverage and build upon their institutional arrangements already initiated for compliance with FATCA in order to meet the reporting requirements of implementing AEOI."

The Panel reviewing the AEOI proposal released its feedback on the 40 submissions it received on the AEOI consultation document in July 2015.[12] Specifically the Panel recommended that legislative changes are introduced that provide for:

a) definitions of financial institutions (FIs) and reportable accounts;

b) exemptions in the form of non-reporting FIs and excluded accounts;

c) reportable account information, including personal data and financial data of non-Hong Kong tax resident account holders;

d) powers of IRD to collect and access to information from financial institutions; and

e) sanctions for financial institutions for non-compliance and account holders for false self-certification.

The HKSAR Government accepted the recommendations, and in its media release of 12 October 2015, indicated that it would be targeting early 2016 to introduce a bill into LegCo. The media release was accompanied by the HKSAR Government's consolidated response to the proposals for AEOI.[13]

The Inland Revenue (Amendment) (No. 3) Ordinance 2016 (the Amendment Bill) was gazetted on 8 January 2016, and had its first reading in a LegCo meeting on 20 January 2016. The main proposals echo the recommended changes by the Panel as set out above. Accompanying the Amendment Bill was a background brief prepared by the LegCo Secretariat on 1 February 2016.[14] Submissions were

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[11] EY, "Hong Kong joins the drive for the automatic exchange of information" (2014) *Global Tax Alert* (November), at 2.

[12] Legislative Council, *Automatic Exchange of Financial Account Information in Tax Matters* (6 July 2015), CB(1)1034/14-15(06); available at: http://www.legco.gov.hk/yr14-15/english/panels/fa/papers/fa20150706cb1-1034-6-e.pdf.

[13] Financial Services and Treasury Bureau, *Consultation on Automatic Exchange of Financial Account Information in Tax Matters ("AEOI")* (October 2015); available at: http://www.fstb.gov.hk/tb/en/docs/consolidated-response.pdf.

[14] Legislative Council Secretariat, *Bills Committee on Inland Revenue (Amendment) Bill 2016: Background Paper* (2016) LC paper No. CB(1)518/15-16(03).

received on the Amendment Bill,[15] including from the HKICPA, which suggested that there be a mechanism for account holders to apply to financial institutions and to the HK IRD to get access to and the opportunity to correct their personal data. In line with the Personal Data (Privacy) Ordinance, financial institutions must ensure that the personal data they hold is accurate and allow account holders to review and correct their personal and financial data. No further specific checks will be put in place.[16]

The FSTB reported back on the submissions received on the Amendment Bill in March 2016. Most submitters supported and agreed with the HKSAR's pragmatic policy approach to implementing AEOI.[17] Reciprocity is seen as a key principle upon which the AEOI framework is based. The FSTB agreed to draw up the relevant guidelines for reporting and due diligence (as set out in Schedule 17D to the Amendment Bill) once the Amendment Bill was enacted. It would also keep close contact with the relevant industry when doing this. Low risk financial institutions and excluded accounts were added to Schedule 17C of the Amendment Bill. Sufficient safeguard measures were considered by the FSTB to be in place without the need for any further additions.

The Bills Committee reported back on the Amendment Bill in May 2016. Their report is extensive, indicating that a number of issues were discussed, including whether the HKSAR must fully commit to and implement AEOI (especially since the US has yet to fully commit to it), and safeguards for privacy. Notwithstanding the tenor of the discussion, the Bills Committee and the Administration did not recommend any Committee Stage Amendments (CSA). The Amendment Bill was enacted with effect from 30 June 2016.

Further details on the HK IRD's interpretation and practice with respect to exchange of information is available in its DIPN 47 (revised), the latest version current as at January 2014.[18] This practice statement will no doubt need to be revised further once AEOI is fully operational to ensure the HKSAR Inland Revenue Department's (HK IRD's) practice is in accord with the amendments to the Inland Revenue Ordinance.

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[15] Submissions were received from: Asia Securities Industry & Financial Markets Association; Hong Kong Institute of Certified Public Accountants; Hong Kong Investment Funds Association; Hong Kong Trustees' Association; International Chamber of Commerce – Hong Kong, China; The Association of Hong Kong Accountants; The Chinese General Chamber of Commerce; The Hong Kong Association of Banks; The Hong Kong Federation of Insurers; The Institute of Certified Management Accountants (Hong Kong Branch); and STEP Hong Kong Ltd.

[16] See further Financial Services and the Treasury Bureau, *Response to further comments raised by the Hong Kong Institute of Certified Public Accountants ("HKICPA")* (May 2016).

[17] Financial Services and the Treasury Bureau, *Bills Committee on Inland Revenue (Amendment) Bill 2016: Follow up to the meeting on 1 March 2016* (March 2106).

[18] Inland Revenue Department Hong Kong, Exchange of Information" (2014) *DIPN* (47) Revised.

As a consequence of the tight timeframe, the commitment by the HKSAR to commence its first AEOI was made for no later than by the end of 2018.[19] Consequently, the HKSAR will not be an early adopter of AEOI but would be joining over 100 jurisdictions that have committed to AEOI through use of the Common Reporting Standard (CRS) and Country by Country (CbC) reporting.

The CRS requires financial institutions to perform due diligence procedures and to transmit systematically financial data from their non-resident customers. The type of information and the due diligence to put in place for all financial accounts are defined by the CRS, and include: interest, dividends, account balances or values, income from certain insurance products, sales proceeds from financial assets and other income generated with respect to assets held in the account or payments made with respect to an account.[20] The financial institutions involved include: custodial institutions, depository institutions, investment entities and specified insurance companies. The HK IRD will act as the competent authority for the HKSAR.

The HKSAR's timeline for collecting and reporting information is set out below:

- January 2017: data capture begins by identifying financial accounts held by residents of the reportable jurisdiction (those that the HKSAR has a signed competent authority agreement with concerning AEOI);

- Mid-2018: financial institutions transmit data to the tax authority of their jurisdiction for calendar year 2017;

- September 2018: this data is then transmitted to the tax authorities of the relevant jurisdictions that the HKSAR has a signed competent authority agreement with concerning AEOI;

- From 2019 going forward: identify and transmit reportable accounts on a regular basis.

The HKSAR will require a new Schedule to be included in the Inland Revenue Ordinance by the end of 2016 to facilitate this aspect of AEOI. A key issue with AEOI is determining tax residence. Tax residence will be determined through the normal tests of a person's physical presence or time spent

[19] See Inland Revenue Department (HK), *Government committed to timely implementation of AEOI in Hong Kong* (October 12, 2015); available at: http://www.ird.gov.hk/eng/ppr/archives/15101201.htm.

[20] See further: http://www.ird.gov.hk/eng/pdf/2016/aeoi_pam3.pdf.

in a particular place (the 183 day within a tax year rule). For a company the usual tests of the place of incorporation or whether the centre of management and control is located, will be applied.[21]

In most cases, self-certification, as set out by the international standard for AEOI, is to be applied by account holders.[22] To assist FIs to meet their AEOI obligations, the HK IRD has added links on its website to details of the relevant legislation, and to guidance for FIs, including the IRD's views on the due diligence procedures required by the OECD's CbC reporting requirements.[23]

As at 30 June 2016, the HKSAR has a CDTA or TIEA in place with 42 jurisdictions, and will identify those jurisdictions within this group that have appropriate AEOI procedures in place, for the HKSAR to determine to be its targeted AEOI partners. The HKSAR is looking to further expand this network of CDTAs and TIEAs during 2016-17, having several TIEAs under negotiation at the time of writing this paper.

The overarching focus for the HKSAR, it appears, is to do all that it can within these constraints to ensure that it protects the confidentiality of information of taxpayers where this information is held within the HKSAR. One area where the HKSAR is expected to face some difficulty is with respect to companies and their cross border operations and transactions, with the need for increased disclosure of information and increased pressure to exchange tax information. In particular, the OECD's BEPS Action Plan 13, which is concerned with transfer pricing expectations, will provide challenges for the HKSAR.[24] The low level public response by the HKSAR to BEPS developments,

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[21] As the HKSAR uses a territorial-based tax system, the issue of residents v non-residents become principally an issue with respect to cross-border transactions – the CDTAs and TIEAs operate in this regard.

[22] See further the OECD's AEOI portal: http://www.oecd.org/tax/automatic-exchange/.

[23] See further: http://www.ird.gov.hk/eng/tax/dta_aeoi.htm.

[24] The OECD's 15 Action Plans comprise:

- Explanatory Statement 2015 Explanatory Statement 2015
- Action 1: Addressing the Tax Challenges of the Digital Economy
- Action 2: Neutralising the Effects of Hybrid Mismatch Arrangements
- Action 3: Designing Effective Controlled Foreign Company Rules
- Action 4: Limiting Base Erosion Involving Interest Deductions and Other Financial Payments
- Action 5: Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance
- Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances
- Action 7: Preventing the Artificial Avoidance of Permanent Establishment Status
- Actions 8-10: Aligning Transfer Pricing Outcomes with Value Creation
- Action 11: Measuring and Monitoring BEPS
- Action 12: Mandatory Disclosure Rules
- Action 13: Guidance on Transfer Pricing Documentation and Country-by-Country Reporting

until June 2016 at least, is in contrast to other jurisdictions that are not at the forefront of BEPS (or members of the G20), such as New Zealand.[25]

3.0 Other international tax developments: engaging with BEPS

The last major international tax development that this paper will review is the HKSAR's engagement with BEPS, focussing on aspects of BEPS outside of AEOI (which are largely addressed by Action Plan 13 and have already been discussed in this paper). In this regard, the HKSAR was largely silent on its approach to BEPS, until the Budget 2016-17 speech delivered on 24 February 2016 by the Financial Secretary, Hon John C Tsang, who stated:[26]

> Hong Kong is also obliged to implement the project of the Group of Twenty against base erosion and profit shifting. *We shall conduct analysis, consult the trade and consider participating in an international framework* being developed by the Organisation for Economic Cooperation and Development.

The Financial Secretary also indicated that the HKSAR is committed to modernising its tax legislation to ensure that it maintains a fair tax environment, aligns its tax system with international standards, and enhances its overall competitiveness. Clearly the HKSAR will need to make some legislative and practice changes in the not too distant future so as to move towards being "BEPS compliant".

At two relatively recent conferences, the HK Deputy Commissioner of Inland Revenue (CIR) indicated that the HKSAR will be working to introduce a profits tax exemption for offshore funds and a concessionary tax regime for aircraft leasing.[27] While not significant in themselves, these announcements demonstrate further movement by the HKSAR to engage with the international tax community.

In relation to BEPS, priority is to be given to four BEPS action points where there are internationally agreed minimum standards, namely: review of harmful tax practices and spontaneous exchange of

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- Action 14: Making Dispute Resolution Mechanisms More Effective
- Action 15: Developing a Multilateral Instrument to Modify Bilateral Tax Treaties

See further http://www.oecd.org/ctp/beps-about.htm.

[25] See Adrian Sawyer, "New Zealand: Update on BEPS and FATCA" (2015) 17(4) *Derivatives and Financial Instruments* (9 July) online.

[26] See PwC, *Hong Kong is embarking on the BEPS journey* (2016) May. See also Hon John C Tsang (Financial Secretary), *Budget 2016-17 Speech* (2016) para 151; available at: http://www.budget.gov.hk/2016/eng/pdf/e_budgetspeech2016-17.pdf (emphasis added).

[27] See further: 2016 Global Tax Symposium- Asia, which was organised by PWC (April 27-28, 2016); and 2016 Annual Conference organised by the Association of Chartered Certified Accountants (ACCA) (30 April 2016).

information on certain tax rulings (Action 5); model tax treaty provisions to prevent treaty abuse (Action 6), CbC reporting (Action 13) and improvements to cross border tax dispute resolution (Action 14).

The top priority area for the HKSAR is transfer pricing where it is looking to develop comprehensive legislation and documentation requirements (which will need to align with CbC reporting requirements). This will follow consultation which is scheduled to start in the last part of 2016. The HKSAR is also looking to ensure it will be able to implement the requirements of Action 15 concerning the introduction of a multilateral instrument. Following approaches from some treaty partners, the HKSAR may introduce a simplified limitation of benefits (LOB) rule and principle purpose test (PPT) as part of its standard CDTA in the future.[28] Furthermore, with the PRC being a signatory to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (Multilateral Convention) and specifically extending its application to Hong Kong, then the HKSAR will have obligations and benefits like any other signatory.[29] The PRC signed on behalf of the HKSAR as the HKSAR could not be a signatory itself given it is not a sovereign state.

In a reply concerning the Estimates of Expenditure for 2016-17, the following reply was given concerning the costs associated with the HKSAR's 'obligations' with respect to BEPS:[30]

> In November 2015, the Group of Twenty ("G20") endorsed a package of measures to tackle Base Erosion and Profit Shifting ("BEPS Package"). Proposed by the Organisation for Economic Co-operation and Development, the BEPS Package covers 15 areas. It aims to ensure that multinational corporations pay a fair share of taxes in respect of their profits and to plug the loophole of "double non-taxation" among jurisdictions. *The Administration is conducting analysis on the BEPS package and will set our work priorities. We will also consult the industry on the strategies for implementing the relevant proposals at an appropriate juncture and then proceed with the necessary legislative amendment exercise*.
>
> As regards the preparatory work undertaken by the Inland Revenue Department (IRD), *it is mainly coordinated by a Deputy Commissioner who leads the Tax Treaty Section to take up the*

[28] The LOB article(s) in a CDTA is designed to eliminate treaty shopping. These LOB articles deny the benefits of the tax treaty to residents that do not meet additional tests or requirements, such as legal nature, ownership, and general activities. The LOB is a specific anti-abuse rule. The PPT is a general ant-abuse rule more akin to an general anti-avoidance rule (GAAR).

[29] The PRC signed the multilateral convention on 27 August 2013, with entry into force on1 February 2016. See further: http://www.oecd.org/tax/exchange-of-tax-information/convention-on-mutual-administrative-assistance-in-tax-matters.htm.

[30] Commissioner of Inland Revenue, "Examination of Estimates of Expenditure 2016-17 (FSTB9Tsy)033 (2016); available at: http://www.ird.gov.hk/eng/pdf/fcreplye/fstb(tsy)033_16_eng.pdf (emphasis added).

relevant tasks. At the present stage, since such preparatory work forms part of the day-to-day duties of the officers concerned, information on the number of officers dedicated to the related work (and their respective ranks) or the estimated expenditure for such work is not available.

It is anticipated that implementation of the G20's BEPS package will create additional workload for IRD. IRD will closely monitor the situation and its manpower need. *To cope with the increasing workload arising from various initiatives on international tax cooperation (including the implementation of Automatic Exchange of Financial Account Information in Tax Matters, the BEPS package, and the negotiation of comprehensive agreements for the avoidance of double taxation with trading partners), IRD will create seven non-directorate posts (two of which are supernumerary posts for five years) in 2016-17 to strengthen the relevant support*.

This response would suggest that, at that time, the level of work done by the HKSAR with respect to BEPS, outside of AEOI, is significant but with a lot of measures yet to be undertaken. The provision of additional resourcing in the near future indicates the level of work on BEPS-related matters will escalate.

A significant development was the announcement on 20 June 2016 by the HKSAR Government concerning its engagement with BEPS.[31] The HKSAR Government indicated to the OECD that the HKSAR had accepted the OECD's invitation to join the inclusive framework for implementation of the BEPS package of measures. The HKSAR would join in the name of "Hong Kong, China", as an Associate. In becoming an Associate party with respect to BEPS, the HKSAR has committed to the comprehensive BEPS package, including its four minimum standards. These four standards, as noted previously, comprise: harmful tax practices; tax treaty abuse; CbC reporting requirements; and improvements in cross-border tax dispute resolution. Furthermore, joining BEPS necessitates consistent implementation of the 15 Actions, where they are relevant to the HKSAR. The HK CIR is to represent the HKSAR, and will have the opportunity to in part at least shape the implementation of the BEPS package and ensure there are solutions that will work for the HKSAR.

Professor K C Chan, the Secretary for the FSTB, further observed: [32]

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[31] Hong Kong Government, *Hong Kong to join inclusive framework for implementation of package against base erosion and profit shifting* (2016); available at: http://www.info.gov.hk/gia/general/201606/20/P201606200520.htm. See also comments made by each of the Big 4 CA firms in Hong Kong.

[32] See further Mary Swire, "Hong Kong to Participate in BEPS Project as Associate" (20 June 2016); at http://www.tax-news.com/news/Hong_Kong_To_Participate_In_BEPS_Project_As_Associate____71508.html#sthash.ulwGmx91.dpuf (emphasis added).

> Noting that the timing of implementation may vary to reflect the level of development of countries and jurisdictions, *Hong Kong's commitment to implement the BEPS package is subject to timely passage of the necessary legislative amendments*. In coming up with the timelines for implementation, we will take into account relevant factors such as the *characteristics of the domestic tax regime, the envisaged magnitude of legislative changes involved, and the practical need to prioritize amongst the BEPS measures*.
>
> The Government is conducting analysis on the BEPS package, with a view to *mapping out our work priorities*. We will consult the industry on the strategy for implementing the relevant proposals at an appropriate juncture and prepare for taking forward the necessary legislative amendments.

This decision by the HKSAR to be actively involved to meet the key principles underlying the BEPS initiatives will be important in maintaining its status as a desirable business location. Big 4 accounting firm EY, state in this regard:[33]

> With these BEPS changes (particularly around transparency), there will inevitably be additional burdens placed on taxpayers around reporting and indeed reviewing their operating models to facilitate compliance with the new international standards. However, *improving Hong Kong's reputation as an internationally compliant player,* particularly in a world now characterized by greater transparency, *will likely result in higher benefits or lesser challenges from other tax authorities to businesses who would like to access Hong Kong's simple and attractive tax regime*.

In terms of the status of the HKSAR's BEPS action plan implementation, the following table outlines an assessment from another Big 4 accounting firm Deloitte, which is supplemented through further analysis by the writer. This analysis was prepared before the release of the most recent consultation paper anon BEPS-related items:[34]

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[33] EY, Hong Kong's OECD BEPS Associate status requires implementation of BEPS minimum standards" (2016) *International Tax and TP Alert* (June), at 3 (emphasis added).

[34] Deloitte, *BEPS Actions implementation by country: Hong Kong* (September 2016); available at: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-beps-actions-implementation-hong-kong.pdf.

Table 1: The HKSAR's OECD BEPS Readiness

Action	OECD Categorisation	Notes on local country implementation	Expected timing
VAT on business to customers digital services (Action 1)	Common approach	The HKSAR does not impose VAT. The IRD intends to issue a DIPN on the digital economy	Not yet known
Hybrids (Action 2)	Common approach	The HKSAR's DIPN on the taxation of hybrid instruments is not aimed at avoiding double non-taxation with a treaty country. The IRD plans to introduce legislation to address hybrid mismatch arrangements. Legislation was enacted to clarify tax treatment of regulatory capital securities comprising certain hybrid instruments under Basel III follows that of debt.	Not yet known Legislation was passed into law on 26 May 2016
CFCs (Action 3)	Best practice	As the HKSAR has a source-based tax system and does not tax dividends, not specific rules are expected.	N/A
Interest deductions (Action 4)	Common approach	The HKSAR has specific rule limiting interest deductions, especially interest paid to non-residents. It does not have thin capitalisation rules. The IRD may review the interest deduction rules.	Not yet known
Harmful tax practices (Action 5)	Minimum standard	The IRD will review and amend provisions found to be harmful, and consider mandatory spontaneous EOI on certain rulings.	Not yet known
Prevent treaty abuse (Action 6)	Minimum standard	The IRD will consider whether an applicant would be entitled to benefits under a treaty when processing an application for a certificate of residence.	Not yet known
Permanent establishment status (Action 7)	Revision of existing standard	The IRD will amend the legislation and issue a DIPN to provide more guidance.	Not yet known
Transfer pricing (Actions 8-10)	Revision of existing standard	The HKSAR has two DIPNs providing guidance which generally follow OECD guidelines. Transfer pricing is a high priority for the IRD, and will consult with the public and introduce bills to LegCo for review and approval. The focus area will be the alignment of profits with economic activities.	Not yet known
Measuring and Monitoring BEPS (Action 11)	Common approach	The actions taken under CbC (Action 13) are to complement the economic analysis of BEPS.	N/A
Disclosure of aggressive tax planning (Action 12)	Best practice	Legislation on automatic exchange of financial account information has been introduced.	This was enacted with effect from 30 June 2016, with the first AEOI to commence by end of 2018.
Transfer pricing documentation & CbC reporting (Action 13)	Common approach Minimum	As noted above, transfer pricing is a high priority with the IRD to review the need to update current practices, including the revised documentation approach recommended by the G20/OECD. The IRD will consult, introduce bills to LegCo	

	standard	for review and approval, and enter into competent authority agreements for exchange of CbC reports. The IRD will require multinationals to provide high level information on their global business operations and transfer pricing policies, transactional transfer pricing documentation specific to each country and annual CbC reports for each jurisdiction in which they do business.	Not yet known
Dispute resolution mechanisms effectiveness (Action 14)	Common approach	IRD has indicated that this is one of four priority areas where there are agreed standards with which Hong Kong will cooperate.	Not yet known
Developing a Multilateral Instrument to modify bilateral tax treaties (Action 15)	Common approach	The HKSAR is looking to ensure it will be able to implement the requirements of this action plan.	Not yet known

Another aspect associated with BEPS that will impact on the HKSAR is intra-group financing arrangements which will form part of the transfer pricing Master file under CbC reporting.[35] With an enhanced focus on information transparency, clearly intra-group financing arrangements will need to be well documented and properly supported. The HKSAR promotes itself as a potential regional treasury hub and has introduced tax incentives for corporate treasury centres; as a consequence of BEPS this aspect will need to be closely reviewed.

Concurrent with the time of writing this paper, in a speech delivered to the Asia-Oceania Consultants' Association International Conference, Professor KC Chan (Secretary for the FSTB) stated that the HKSAR is actively involved in another key aspect of BEPS implementation:[36]

> Meanwhile, *Hong Kong is also taking part, as an observer, in the Ad Hoc Group tasked to develop a multilateral instrument for implementing the BEPS treaty-related measures and amending bilateral tax treaties*. The instrument aims to provide an efficient and effective mechanism to implement the tax-treaty related measures resulting from the BEPS Project. The Ad Hoc Group aims to conclude its work and open the multilateral instrument for signature by December 31, 2016.

On 26 October 2016, the HKSAR Government released its consultation paper on measures related to BEPS.[37] The consultation paper reiterates the HKSAR Government's commitment to implementing

[35] See further KPMG, *Hong Kong: Incentives for intra-group financing activities, corporate treasury centres* (30 September 2016); available at: https://home.kpmg.com/xx/en/home/insights/2016/09/tnf-hong-kong-incentives-for-intra-group-financing-activities-corporate-treasury-centres.html. See also, EY, "Hong Kong releases new practice note on corporate treasury centers and interest deductibility" (September 2016) *Global Tax Alert*; at http://www.ey.com/gl/en/services/tax/international-tax/alert--hong-kong-releases-new-practice-note-on-corporate-treasury-centers-and-interest-deductibility.

[36] KC Chan, *Speech to the Asia-Oceania Consultants' Association International Conference* (October 6, 2016); available at: http://www.info.gov.hk/gia/general/201610/06/P2016100600669p.htm.

BEPS, including the four minimum standards. The HKSAR's priority is to put in place a legislative framework for transfer pricing rulings that meet the latest guidance from the OECD, spontaneous exchange of information (EOI) on tax rulings, CbC reporting, and cross-border dispute resolution mechanism.[38] With other BEPs Actions, the HKSAR will monitor international developments, and hence will be a follower.

A fundamental transfer pricing rule will be implemented to enable the Commissioner to adjust the profits and losses of businesses. Penalties to encourage compliance will be introduced. The HKIRD is also working on implementing an advance pricing agreement (APA) regime to support this new fundamental transfer pricing rule.[39]

With respect to CbC, the OECD's templates will be adopted, with a number of exemptions introduced to reduce the costs for some businesses. It expected that through using the EUR750 million (HK$6.8 billion) threshold for CbC reporting, about 150 HKSAR enterprises will need to meet the CbC requirements. Only those jurisdictions that have a CDTA or TIEA, or have signed the Multilateral Convention, will be able to exchange reports with the HKSAR. There will also need to be a Competent Authority agreement entered into between the HKSAR and the other jurisdiction for CbC to operate. MNEs will need to gather information in 2018 and file their first CbC reports to the HKIRD in 2019.[40]

The multilateral instrument is expected to work without any technical difficulties when applied to the HKSAR's CDTAs. The HKSAR has indicated that it is likely to adopt the principle purpose test as its preferred option in updating its CDTAs.[41] The HKSAR intends to introduce a statutory mechanism to ensure timely, effective and efficient resolution of cross-border treaty-related disputes. Most of the HKSAR's CDTAs incorporate the mutual agreement procedure (MAP).[42]

With respect to spontaneous EOI on tax rulings, the HKSAR will include six categories of rulings within this framework:[43]

1. rulings relating to preferential regimes;

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[37] HKSAR Government, *Consultation Paper on measures to counter Base Erosion & Profit Shifting* (October 2016).

[38] See further note 37, Chapter 2.

[39] See further note 37, Chapter 3.

[40] See further note 37, Chapter 4.

[41] See further note 37, Chapter 5.

[42] See further note 37, Chapter 6.

[43] See further note 37, Chapter 6.

2. unilateral APAs and any other cross-border unilateral rulings in respect of transfer pricing;

3. cross-border rulings providing for a downward adjustment of taxable profits;

4. permanent establishment ruling;

5. related party conduit ruling; and

6. any other type of ruling that, in the absence of spontaneous information exchange, could give rise to BEPS concerns.

This framework would apply to both past and future rulings, and would be underpinned by the HKSAR's CDTAs and TIEAs, with exchange to be on a bilateral basis. The HKSAR is also intending to enhance its tax credit system, ensuring that:[44]

1. the CDTAs prevail over any provision in the Inland Revenue Ordinance;

2. the period for claiming a credit be extended to 6 years;

3. the tax credit be a form of last resort;

4. taxpayers must notify the HKIRD of any adjustments to foreign tax payments; and

5. a credit will not be granted if the taxpayer receives unilateral relief.

Further developments are expected with respect to the HKSAR's embracing of BEPS over the coming months, including tabling of draft legislation. The major driver will continue to be the G20/OECD as they strive to ensure jurisdictions are ready to implement the necessary changes to ensure relevant standards are in place and best practice is followed in jurisdictions committed to BEPS implementation.

4.0 Concluding Observations

Much has happened in the last two to three years in the HKSAR with respect to tax transparency and exchange of information, as well as embracing the expectations of BEPS implementation. This commenced with the Global Forum releasing its Phase Two Peer Review Report on the HKSAR in November 2013. This report signalled that the HKSAR was largely compliant with its domestic law and regulations with respect to facilitating tax transparency and exchange of information (in a pre-AEOI environment). A further significant event was the HKSAR concluding an in-substance Model

[44] See further note 37, Chapter 6.

2 IGA under FATCA that took effect in time for the 1 July 2014 implementation date of FATCA. This was followed up by the HKSAR signing a Model 2 IGA later in 2014.

In the area of "business as usual", TIEAs and CDTAs have continued to be negotiated by the HKSAR, bringing the combined total of CDTAs and TIEAs to 42 as at October 2016. The writer would suggest that a focus on these activities, along with working towards implementing AEOI, assisted the HKSAR in being removed from the EU's blacklist of non-cooperative jurisdictions in October 2015.

Importantly, AEOI became a reality for the HKSAR from 30 June 2016 with the enactment of an amendment to the Inland Revenue Ordinance. Financial institutions and account holders need to prepare for the verification and collection of information during 2017 so as to be ready to provide information to the HK IRD for the first information exchange via CbC reporting to other jurisdictions in 2018. Through the PRC signing the Multilateral Convention both on its own behalf and on that of the HKSAR, the HKSAR has effectively become a party to its first major multilateral tax agreement.

Following comments made in Budget 2016, the HKSAR became much more active from June 2016 with respect to the implications of the final Actions under BEPS. This commenced with the public announcement that the HKSAR was formally joining the BEPS implementation nations as an Associate "Hong Kong, China". This means that the HKSAR will be working cooperatively with the G20/OECD implement BEPS and develop standards. This commitment covers not only meeting the minimum standards in the four areas of treaty shopping, CbC reporting, harmful tax practices, and dispute resolution, but also addressing all other relevant BEPS Action Plans. The HKSAR is also actively involved as part of the Ad Hoc group to develop a multilateral instrument for implementing BEPS treaty-related measures and amending bilateral treaties.

The analysis set out in this paper indicates that the HKSAR has become an active player in facilitating the objectives of the BEPS action plans. It also suggest there will be significant activity led by the HK IRD and LegCo over the next year or so, including a sizeable amount of consultation activity with the public, so as to bring the BEPS initiatives to fruition within the HKSAR. The latest consultation paper provides a clear indication of the direction the HKSAR intends to take. It would be fair to say that the HKSAR has evolved from being a reluctant and slow follower to implement exchange of information beyond that of the CDTA, to a jurisdiction that is willing to meet international expectations with respect to AEOI. Indeed, the HKSAR is moving into what the writer sees as "unchartered territory" with its proactive decision to be part of the ad hoc group to develop a multilateral instrument to modify bilateral tax treaties as part of BEPS Action 15.

Future research should review legislative and other changes adopted by the HKSAR focussing on the extent to which the HKSAR has been effective in influencing the implementation of BEPS internationally, as well as the impact this has on business within the HKSAR. Research could also be undertaken as to the extent to which the PRC's approach to BEPS has an influence on the HKSAR. Concerns over taxpayer privacy, additional complexity in the HKAR's tax system, and the impact of potential consultation fatigue, are expected to emerge over the next few years. These are unprecedented times for the HKSAR.