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RECENT DEVELOPMENT OF IMPLEMENTATION OF AEOI/CRS AND BEPS IN HONG KONG

As an international financial centre and a responsible member of the international community to enhance tax transparency and combat cross-border tax evasion, Hong Kong has committed to support the implementation of Automatic Exchange of Financial Account Information (“AEOI”) in accordance with the Common Reporting Standard (“CRS”), and has been taking the necessary steps for the implementation of AEOI/CRS in Hong Kong in recent years.

Subsequent to the enactment of the Inland Revenue (Amendment) (No. 3) Ordinance 2016 on 30 June 2016, financial institutions in Hong Kong have commenced collecting the required information from account holders in relation to periods that start on or after 1 January 2017. Hong Kong will commence the first information exchanges by the end of 2018. However, for the first CRS period, information would initially be provided to Japan and the United Kingdom only.

To accelerate the pace of AEOI and avoid being labelled as a non-cooperative jurisdiction or a “tax haven” which would undermine Hong Kong’s position and competitiveness as an international business and financial centre, the Hong Kong Government introduced the Inland Revenue (Amendment) (No. 2) Ordinance 2017 which came into effect on 1 July 2017 to expand the list of reportable jurisdictions to cover 75 jurisdictions. Furthermore, the Hong Kong Government gazetted the Inland Revenue (Amendment) (No. 5) Bill 2017 on 6 October 2017 to give effect to the Multilateral Convention on Mutual Administration Assistance in Tax Matters (“Multilateral Convention”) in Hong Kong.

Meanwhile, Hong Kong has committed to the comprehensive Base Erosion and Profit Shifting (“BEPS”) Package. The Hong Kong Government launched a two-month consultation in October to December 2016 to collect views on implementation of measures by the Organization for Economic Cooperation and Development (“OECD”) to counter BEPS. The Consultation Report was issued on 31 July 2017 and the relevant amendment bills are expected to be introduced for BEPS legislation by the end of 2017 and the Multilateral Instrument legislation by mid-2018.

1. Automatic Exchange of Financial Account Information (“AEOI”) / Common Reporting Standard (“CRS”)

A. Inland Revenue (Amendment) (No. 3) Ordinance (“2016AO”)

As an international financial centre and a responsible member of the international community to enhance tax transparency and combat cross-border tax evasion, Hong Kong has committed to support the implementation of AEOI in accordance with the CRS. Subsequent to consultations between April and June 2015, the 2016AO was eventually gazetted on 30 June 2016.

The 2016AO sets out a legislative framework for Hong Kong to implement AEOI under a phased timeline with due diligence procedures commencing from 1 January 2017 to facilitate the first information exchanges by September 2018.

The 2016AO covers the following five key areas:

- Scope of financial institutions (“FIs”), reporting FIs/non-reporting FIs, reportable accounts and excluded accounts
- Due diligence and reporting requirements for reporting FIs
- Reportable information to be maintained, furnished and exchanged
- Reportable jurisdictions
- Sanctions provisions

According to the 2016AO, a FI is required to identify financial accounts held by tax residents of reportable jurisdictions in accordance with due diligence procedures. FIs are required to collect the reportable information of these accounts and furnish such information to the Hong Kong Inland Revenue Department (“IRD”). The IRD will then exchange the information with the tax authorities of the AEOI partner jurisdictions on an annual basis. Under the 2016AO, Hong Kong only conducts AEOI with a jurisdiction with which Hong Kong has entered into (1) a Comprehensive Double Taxation Agreement (“CDTA”) or Tax Information Exchange Agreement (“TIEA”); and (2) a Competent Authority Agreement (“CAA”) for AEOI. Regarding the details of the 2016AO, please refer to our September 2016 Tax Flash for details.

B. Inland Revenue (Amendment) (No. 2) Ordinance 2017 (“2017AO”)

Unlike most jurisdictions that have adopted a multilateral basis to implement AEOI, Hong Kong originally planned to implement the AEOI on a bilateral basis and only with those jurisdictions with which Hong Kong has already entered into a CDTA or TIEA. Subsequent to enactment of the 2016AO, Hong Kong has signed bilateral Competent Authority Agreements (“BCAAs”) with Japan and the United Kingdom for conducting AEOI from 2018; and Korea for conducting AEOI from 2019.

Some of the jurisdictions have started the first AEOI exchanges in September 2017 and a considerable number of jurisdictions have indicated to the OECD their interest in conducting AEOI with Hong Kong. However, it takes time for Hong Kong to conclude and sign BCAAs with these jurisdictions. On the other hand, both the OECD and the European Union (“EU”) are closely monitoring the progress in the global implementation of AEOI and have announced that a black list of non-cooperative tax jurisdictions will be prepared. In view of the above, Hong Kong was under pressure to accelerate the process.

The Hong Kong Government introduced the 2017AO to the Legislative Council in March 2017, which seeks to speed up the expansion of the list of reportable jurisdictions to cover 75 reportable jurisdictions for the more effective implementation of the arrangement relating to AEOI. The 2017AO was passed by the Legislative Council on 7 June 2017 and came into operation on 1 July 2017.

The 2017AO changed the definition of “reportable jurisdiction” so that it is no longer necessary for a reportable jurisdiction being a party of a CDTA or a TIEA with Hong Kong. The list of reportable jurisdictions under Schedule 17E of the Inland Revenue Ordinance (“IRO”) was expanded from 2 jurisdictions (Japan and the United Kingdom) to 75 jurisdictions as follows:

<i>Jurisdiction (First Information Period from 1.1.2017 to 31.12.2017)</i>			
1.	Japan	2.	United Kingdom

<i>Jurisdiction (First Information Period from 1.7.2017 to 31.12.2017)</i>			
3.	Antigua and Barbuda	4.	Argentina
5.	Australia	6.	Austria
7.	Bahamas	8.	Belgium
9.	Brazil	10.	Brunei
11.	Bulgaria	12.	Canada
13.	Cayman Islands	14.	Chile
15.	Mainland of China	16.	Colombia
17.	Costa Rica	18.	Croatia
19.	Curacao	20.	Cyprus
21.	Czech	22.	Denmark
23.	Estonia	24.	Faroese
25.	Finland	26.	France
27.	Germany	28.	Gibraltar
29.	Greece	30.	Greenland
31.	Grenada	32.	Guernsey
33.	Hungary	34.	Iceland
35.	India	36.	Indonesia
37.	Ireland	38.	Isle of Man
39.	Israel	40.	Italy
41.	Jersey	42.	Kuwait
43.	Latvia	44.	Lebanon
45.	Liechtenstein	46.	Lithuania
47.	Luxembourg	48.	Malaysia
49.	Malta	50.	Mauritius
51.	Mexico	52.	Montserrat
53.	Netherlands	54.	New Zealand
55.	Norway	56.	Poland
57.	Portugal	58.	Qatar
59.	Romania	60.	Russia
61.	Saint Vincent and the Grenadines	62.	Saudi Arabia
63.	Seychelles	64.	Singapore
65.	Slovak Republic	66.	Slovenia
67.	South Africa	68.	Spain
69.	Sweden	70.	Switzerland
71.	Turkey	72.	United Arab Emirates
73.	Uruguay	74.	Vanuatu

<i>Jurisdiction (First Information Period from 1.1.2018 to 31.12.2018)</i>			
75.	South Korea		

The newly added jurisdictions include the following three categories:

- (a) jurisdictions which have expressed an interest in conducting AEOI with Hong Kong to the OECD or jurisdictions suggested by the OECD;
- (b) Hong Kong’s tax treaty partners which have committed to AEOI; and
- (c) all member states of the EU.

Subsequent to enactment of the 2017AO, Hong Kong FIs are required to identify and collect the information about the financial accounts held by the tax residents of all reportable jurisdictions on the list starting from 1 July 2017, even though Hong Kong does not currently have an agreement in place to conduct AEOI with many of those reportable jurisdictions. Apart from Japan and the United Kingdom (first reporting period being from 1 January to 31 December 2017); and Korea (first reporting period being from 1 January to 31 December 2018), the first reporting period for the remaining 72 jurisdictions covers 1 July to 31 December 2017.

Hong Kong FIs will be required to submit the collected data to the IRD regarding the calendar year 2017 by May 2018. In September 2018, the collected data will then be transmitted by the IRD to the tax authorities of the reportable jurisdictions when arrangements are in place with the reportable jurisdictions concerned to provide the basis for exchange. In the cases of jurisdictions with which Hong Kong does not have an agreement in place for AEOI, the collected data will be kept by the IRD and exchanged with the relevant jurisdictions only after AEOI agreements are concluded with such jurisdictions.

C. Inland Revenue (Amendment) (No. 5) Bill 2017

As mentioned above, Hong Kong originally planned to implement the AEOI on a bilateral basis and only with those jurisdictions with which Hong Kong has already entered into a CDTA or TIEA. However, the Hong Kong Government has considered that since Hong Kong's network of CDTA and TIEA keeps extending and new international standards for exchange of tax information are being introduced under the BEPS initiatives, Hong Kong's previous bilateral approach is no longer efficient or effective.

To accelerate the pace of AEOI and avoid being labelled as a non-cooperative jurisdiction or a "tax haven" which would undermine Hong Kong's position and competitiveness as an international business and financial centre, there is a practical need for Hong Kong to consider adopting a multilateral approach for implementation of AEOI through an extension of the application of the Multilateral Convention to Hong Kong.

The Multilateral Convention is only open for signature by state parties. Since Hong Kong is not a sovereign jurisdiction, it cannot be a direct signatory of the Multilateral Convention. However, China is one of the states participating in the Multilateral Convention. Upon the request of Hong Kong, the Central People's Government has agreed in-principle to extend the application of the Multilateral Convention to Hong Kong.

As a result, the Hong Kong Government introduced the Inland Revenue (Amendment) (No. 5) Bill 2017 on 6 October 2017 which seeks to pave the way for Hong Kong's participation in the Multilateral Convention for the exchange of the necessary information with other jurisdictions under the AEOI and BEPS. Upon passage and enactment of the legislation, the pace and scope of the taxpayers' information to be exchanged by Hong Kong with other jurisdictions would significantly accelerate and enlarge.

2. Base Erosion and Profit Shifting (“BEPS”)

Subsequent to the release of 15 BEPS action plans by the OECD in October 2015, Hong Kong announced that it has accepted the OECD’s invitation to join the inclusive framework for implementation of the BEPS package on 20 June 2016. The Hong Kong Government issued a Consultation Paper on measures to counter BEPS on 26 October 2016. The consultation was finished on 31 December 2016 and the Consultation Report was issued on 31 July 2017.

The Hong Kong Government’s proposed implementations strategy focused on the four minimum standards set by the OECD whilst maintaining Hong Kong’s simple and low tax regime. The four minimum standards include countering harmful tax practices (Action 5), preventing treaty abuse (Action 6), imposing Country-by-Country (“CbC”) Reporting (Action 13) and improving cross-border dispute resolution mechanism (Action 14). The Hong Kong Government plans to introduce the amendment bill for BEPS legislation by the end of 2017.

The Consultation Report covers the following topics:

- Transfer Pricing Regulatory Regime
- Transfer Pricing Documentation and CbC Reporting
- Multilateral Instrument (“MLI”)
- Dispute Resolution Mechanism
- Spontaneous Exchange of Information on Tax Ruling
- Harmful Tax Practice
- Double Taxation Relief

A. Transfer Pricing Regulatory Regime

According to the Consultation Report, there has been overwhelming support for codifying the transfer pricing rules that are consistent with the OECD’s Transfer Pricing Guidelines for incorporation into Hong Kong’s tax legislations. The Commissioner of Inland Revenue will be empowered to adjust the profits or losses of an enterprise where the actual provision made or imposed between two associated persons departs from the provision which would have been made between independent persons and has created a tax advantage. It is important to note that the transfer pricing rules should be applicable to both cross-border and domestic transactions.

Filing tax returns with incorrect information on transfer pricing without reasonable excuse would be an offence carrying a fine at level 3 (HK\$10,000) plus an amount trebling the tax undercharged. On the other hand, filing tax returns with incorrect information on transfer pricing willfully with intent to evade tax would be an offence carrying a fine at level 5 (HK\$50,000) plus an amount trebling the tax undercharged and imprisonment for three years. The IRD will consider all facts and circumstances of individual cases in determining whether or not the taxpayers have a reasonable excuse to be exempt from the penalties, and the preparation of OECD-compliant transfer pricing documentation will be one of the considerations.

B. Transfer Pricing Documentation and CbC Reporting

In accordance with the OECD’s requirements, the Consultation Paper proposed to mandate the preparation of transfer pricing documentation based on the three-tier standardized approach, namely master file, local file and CbC report.

Exemption thresholds for the preparation of master and local files

According to the Consultation Report, the exemption threshold has been relaxed based on the business size of a company as well as its related party transactions amount. Specifically, an enterprise engaging in transactions with associated enterprises will not be required to prepare master and local files if it can meet either one of the following exemption:

(a) Exemption based on size of business (satisfies any two of the three conditions)

- (i) Total annual revenue not more than HK\$200 million;
- (ii) Total assets not more than HK\$200 million; and
- (iii) Not more than 100 employees.

(b) Exemption based on related party transactions (by category of transactions)

- (i) Transfer of properties (other than financial assets and intangibles) less than HK\$220 million;
- (ii) Transactions of financial assets less than HK\$110 million;
- (iii) Transfer of intangibles less than HK\$110 million; and
- (iv) Any other transaction (e.g. service income and royalty income) less than HK\$44 million.

According to the above, if an enterprise is fully exempted from preparing a local file, it will not be required to prepare the master file either.

CbC Report

As mandated by the OECD, ultimate parent entities of the Multinational Enterprises (“MNEs”) that are residents in Hong Kong with annual consolidated revenue equal to or exceeding EUR750 million (equivalent to HK\$6.8 billion) would be required to prepare and file CbC reports in Hong Kong for the accounting periods commencing on or after 1 January 2018, subject to the necessary legislative amendments. Regarding the general requirements and transitional arrangement of CbC Reporting, please refer to our April 2017 Tax Flash for details.

It was proposed that CbC reports are to be exchanged automatically between Hong Kong and other jurisdictions with which Hong Kong has concluded a CDTA/TIEA as well as a CAA. In this regard, introduction of the Inland Revenue (Amendment) (No. 5) Bill 2017 on 6 October 2017 which seeks to pave the way for Hong Kong’s participation in the Multilateral Convention will help to provide a platform for the exchange of CbC reports with other jurisdictions effectively.

C. Other Salient Points of the Consultation Report

- Hong Kong will provide a statutory basis for the existing Advance Pricing Arrangement (“APA”) scheme and provide the IRD more flexibility to cater for unilateral, bilateral and multilateral APAs.

- Hong Kong will implement the MLI so as to modify the CDTAs in a synchronised and efficient manner. The Hong Kong Government plans to introduce an amendment bill for MLI legislation by mid-2018.
- The time bar for claiming tax credits will be extended to six years.
- Hong Kong will not impose thin capitalisation rule.
- Hong Kong will introduce legislation to formalize the adoption of mutual agreement procedures.

3. POINTS TO NOTE

While we are still awaiting the Hong Kong Government to introduce the relevant legislations on the transfer pricing documentation requirement and other BEPS measures in Hong Kong, it is clear that the worldwide trend is moving towards greater transparency and more comprehensive disclosure.

Parent surrogate filing implementation issues for CbC Reporting will be addressed in the upcoming Departmental Interpretation and Practice Notes. It should be noted that if the Multilateral Convention is not applicable to Hong Kong in time, MNEs with ultimate parent entities which are tax residents in Hong Kong may be required to file the CbC reports individually in the relevant jurisdictions of their subsidiaries until the Multilateral Convention takes effect. In this regard, further clarifications from the IRD would be highly required.

On the other hand, while the Hong Kong Government plans to introduce the amendment bill for BEPS legislation by the end of 2017, it has reiterated that it will take a pragmatic approach to minimize the compliance burdens arising from the new transfer pricing regime and the transfer pricing documentation requirement, in particular for small and medium enterprises. However, whether the domestic related party transactions should be included in the preparation of transfer pricing documentation is one of the main concerns of the taxpayers.

In view of the rapid development of implementation of AEOI/CRS and BEPS in Hong Kong, taxpayers should consider how the exchange of information under AEOI and BEPS would have impact on them and seek professional advice. In view of the upcoming mandatory transfer pricing documentation requirement, taxpayers in Hong Kong are recommended to proactively assess their potential filing obligations as well as tax exposure from a transfer pricing perspective.

RSM Tax Advisory (Hong Kong) Limited

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- Advise on tax efficient holding and operational structures for new cross-border investment, including the of Hong Kong and Chinese business entities
- Review existing cross-border investment structures, advise on identified deficiencies, quantify any potential exposure from such deficiencies, and further advise on restructuring approach and procedures
- Assist clients to discuss and clarify matters with tax officials, including transfer pricing and advance rulings
- Act as client representative in tax audits and tax investigations
- Provide transaction support services on mergers and acquisitions, including tax due diligence, deal structure advice, tax health checks, related human resources arrangements and other tax compliance and consultation services
- Advise on human resources and structuring employment arrangements in a tax-efficient manner
- Advise on tax equalization schemes
- Provide tax compliance services for individual and corporate clients in Hong Kong and China

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