Hong Kong’s Involvement with International Tax Reform: What’s the ‘BEPS’?

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HONG KONG’S INVOLVEMENT WITH INTERNATIONAL TAX REFORM: WHAT’S THE ‘BEPS’?

Adrian Sawyer*

Abstract

The Hong Kong Special Administrative Region (HKSAR) was initially a reluctant participant in major international tax reforms initiated by the OECD, including (automatic) exchange of information (AEOI). In more recent times, as outlined in an earlier paper by the author,1 the HKSAR has become an active participant working at the forefront of the Base Erosion and Profit Shifting (BEPS) initiatives, including being part of the ad hoc group that developed a multilateral instrument under BEPS Action 15. This paper provides a forward-looking overview of BEPS, outlines the HKSAR’s engagement with BEPS and international tax reform, and offer some thoughts on where BEPS may take us.

1. INTRODUCTION

The last four or so 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)2 released its Phase Two Peer Review Report on the HKSAR in November 2013.3 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-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.⁴

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.⁵ 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 CDAs have continued to be negotiated by the HKSAR.

In 2015 the HKSAR spent a short period on the European Union’s (EU’s) blacklist of third country non-cooperative tax jurisdictions.⁶ 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.

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. AEOI became a reality for the HKSAR from 30 June 2016 with the enactment of an amendment to the Inland Revenue Ordinance through the Inland Revenue (Amendment) (No 3) Ordinance 2016. Financial institutions and account holders as a consequence need to prepare for the verification and collection of information during 2017 so as to be ready to provide information to the HKIRD for the first information exchange via CbC reporting to other jurisdictions in 2018. Even with the PRC signing the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (Multilateral Convention)⁷ on its own behalf only and not also on behalf of the HKSAR, the HKSAR has not as yet become a party to its first major multilateral tax agreement. This is expected to change within the next year.

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⁴ 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.


In relation to the OECD’s Base Erosion Profit Shifting (BEPS) Action Plans, the HKSAR has been active but largely a follower.\textsuperscript{8} 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 required the HKSAR to review its current state of preparedness to meet BEPS expectations. In particular, the HKSAR set priority for it to meet four agreed BEPS minimum standards:

- Harmful tax practices & spontaneous EOI 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).

This approach is designed to show HKSAR wishes to have a reputation as an internationally compliant player and is attractive for business. Consultation on BEPS during 2016 is expected to see draft legislation be made publicly available within the first half 2017 to address the following issues:

- Enhanced transfer pricing;
- CbC reporting;
- Multilateral Instrument – Mutual Agreement Procedure (MAP) updating in CDTAs;

\textsuperscript{8} The OECD’s 15 Action Plans comprise:
- 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 14: Making Dispute Resolution Mechanisms More Effective
- Action 15: Developing a Multilateral Instrument to Modify Bilateral Tax Treaties

• Spontaneous EOI on tax rulings; and

• Enhanced tax credit system.

The remainder of this paper is organised as follows. The next section provides a brief overview of the HKSAR’s 2017 Budget, along with developments and changes that are expected to the HKSAR’s approach to transfer pricing. Section 3 provides an update on how the HKSAR is engaging with BEPS, which is followed in section 4 by a more detailed analysis of the multilateral instrument to implement BEPS Action 15.9 Section 5 looks forward to a post-BEPS world, with section 6 setting out some concluding observations.

2. BUDGET 2017 AND TRANSFER PRICING MATTERS

Paul Chan, Financial Secretary for the HKSAR, indicated in 2018 there will be a (macroeconomic) review of HKSAR’s tax system in broad terms, with new unit in the FSTB. The aim of this review is to:10

• seek to align HKSAR’s tax practices with international standards;

• study ways to foster development of pillar industries, (including financial services, tourism, trading and logistics, and professional and producer services);

• explore ways to broaden its tax base and increase its tax revenue.

A proposal to extend profits tax exemption from offshore private equity funds to onshore privately-offered open-ended funds companies has been launched, with consultation to come.11 Furthermore, there is a proposal to develop a regime to attract aircraft financing and leasing business to HKSAR. This regime is intended to make the HKSAR more competitive than Singapore and Ireland. The leasing net tax rate will be 1.65 percent (that is, 20 percent x 8.255), with a 4 percent maximum rate with depreciation. This can be compared to Ireland 12.5 percent, and Singapore with 5 percent and 10 percent (most are at the latter rate). However, this regime will need to be compliant with BEPS.12 The HKSAR also intends to continue to enhance is CDTA network.

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11 See LC CB(1)660/16-17(04).

12 See Inland Revenue (Amendment) (No. 2) Bill 2017.
In a survey conducted post the 2017 HKSAR budget, KPMG China found that 94 percent of respondents believe the HKSAR’s tax system is competitive. However, in terms of future competitiveness, this level dropped to 49 percent of respondents believing the HKSAR’s tax system will remain competitive, and 45 percent believe it will be less competitive. Unsurprisingly, the HKSAR needs to tread carefully as it embraces change to its international tax regime, including the impact of embracing BEPS.

The HKSAR indicated that it will be expanding its AEOI network to all treaty partners committed to AEOI. It will also amend the Inland Revenue Ordinance (an amendment Bill is to be released), and will work on increasing the level of public awareness.\(^\text{13}\) AEOI will commence with Japan and the UK from 2018.\(^\text{14}\) However, some concern has been expressed over the impact of AEOI.

The HKSAR has outlined the criteria for potential AEOI partners: it will be Competent Authority Agreements (CAA) signatories’ first, then other CDTA/TIEA partners. The HKSAR has signed CCAs for AEOI with: Belgium, Canada, Guernsey, Italy, Japan, Korea, Mexico, the Netherlands and the UK. Financial institutions are advised to start due diligence and collect information now, as the first exchange will occur in September 2018. In particular, data from financial institutions (FIs) will need to be collected and provided to the Hong Kong Inland Revenue Department (HKIRD) by May 2018. In this regard, the HKIRD to provide guidelines on what is required for due diligence. Penalties will be imposed for knowingly/recklessly providing misleading, false or incorrect information in self certification.\(^\text{15}\) For the HKSAR, the challenge is balancing a simple, neutral and highly transparent regime, with mandated documentation. There is also the need to balance tax transparency with personal data privacy.

In the area of transfer pricing, a big challenge for the HKSAR is how to reconcile a territorial tax system with transfer pricing, and avoid being considered to be engaging in harmful tax practice. With respect to BEPS consultation, public comments made via submissions will be released, with draft legislation to be tabled in first half of 2017. Accompanying these changes is the need for the HKSAR to introduce an Advance Pricing Agreement (APA) regime. Draft guidelines are yet to be publicly released. The HKSAR has indicated that it will incorporate a simplified Limitation of Benefits Rule (LBR) and a Principle Purpose Test (PPT) into all future CDTAs. It has also stated

\(^\text{13}\) See LC CB(1)660/16-17(09).
\(^\text{14}\) See LC CB(1)660/16-17(10).
\(^\text{15}\) See s 80(2E) Inland Revenue Ordinance.
that it will sign Multilateral Instrument, which occurred on 7 June 2017 in Paris, France.\textsuperscript{16} The HKSAR will then set in motion the processes to ratify the instrument domestically.

In going forward, multinational enterprises (MNEs) must be prepared and seek advice. They may need to restructure arrangements to be compliant. They should assess new risks and improve their record keeping. However, there remain some unclear issues in transfer pricing, including: ‘related party’; ‘incorrect tax return’; HKSAR source rules and transfer pricing; filing dates for master and local file. The HKSAR needs a comprehensive transfer pricing regime with specific documentation rules and increased scrutiny on related-party transactions in audits. In this regard, will it adopt the OECD’s Model Tax Convention and the OECD’s Transfer Pricing Guidelines?\textsuperscript{17} As at the time of writing this remains unclear.

LegCo, in justifying new staffing roles (emphasis added):\textsuperscript{18}

It is also important to uphold the reputation of Hong Kong by ensuring our compliance with the relevant standards and defend our position in a robust manner in the international arena as and when necessary. Such work will require coordination within the Government at a strategic level.

Proposed transfer pricing documentation requirements will be based on OECD’s three-tiered standardised approach, namely: Master file, Local file and country by country report (CbCR). Further details are set out in the following table from LegCo:\textsuperscript{19}

\begin{table}
\centering
\begin{tabular}{|c|c|}
\hline
Proposed Transfer Pricing Documentation Requirements & Description \\
\hline
Master file & Detailed financial information of the group
\hline
Local file & Information relevant to the operations of the local entity
\hline
Country by country report (CbCR) & Summary of the group’s worldwide operations
\hline
\end{tabular}
\end{table}

\textsuperscript{16} See OECD, \textit{Ground-breaking multilateral BEPS Convention to be signed at OECD on Wednesday 7 June} (June 2017); available at: http://www.oecd.orgctp/beps/ground-breaking-multilateral-beps-convention-to-be-signed-at-oecd.htm.


\textsuperscript{18} LegCo, \textit{Legislative Council Panel on Financial Affairs Proposed Creation of two directorate posts in the Financial Services and the Treasury Bureau and the Inland Revenue Department}, LC Paper No. CB(1)363/16-17(09) (January 2017), at 5.

\textsuperscript{19} LegCo, \textit{Information Note: Measures to counter Base Erosion and Profit Shifting} IN02/16-17 (November 2016), at 8.
Table 1: FSTB: Proposed response to CbCR

<table>
<thead>
<tr>
<th>Report tier and scope</th>
<th>Proposed application and exemption</th>
<th>Proposed time frame</th>
<th>Proposed penalty for non-compliance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Master file</td>
<td>• To be prepared by enterprises carrying on trades or businesses in Hong Kong and engaging in transactions with associated enterprises.</td>
<td>• To be prepared for each fiscal year and retained for not less than seven years.</td>
<td>• Failure to comply with the requirements relating to the Master/Local file: a fine at level 6 (at present HK$100,000).</td>
</tr>
<tr>
<td>Local file</td>
<td>• Exemption for preparing Master/Local file is given to those enterprises which satisfy two of the following three conditions: (a) total annual revenue not more than HK$100 million; (b) total assets not more than HK$100 million; and (c) no more than 100 employees.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>CbC report</td>
<td>• To be prepared by multinational enterprises with annual consolidated group revenue of €750 million(^1) (HK$6.8 billion) or above.</td>
<td>• To be filed within 12 months from the last day of the fiscal year.</td>
<td>• Failure to submit CbC reports: a fine at level 6 (at present HK$100,000).</td>
</tr>
</tbody>
</table>

Note: (1) According to OECD, the agreed threshold is €750 million or a near equivalent amount in domestic currency as of January 2015 (i.e. about HK$6.8 billion).

It is useful before going on further to briefly summarise what BEPS is seeking to achieve. According to Owens:\(^20\)

“… There are three broad objectives that are set for BEPS. One is to get a fairer sharing of the tax base between countries. The second is the counteraction of non-compliance, particularly by means of MNEs using tax havens. And the third is to update the rules of the game that the OECD has been working on for the last 50 years. The 15 Action points can be conveniently grouped into three groupings. There are those that are primarily concerned with transparency: the disclosure provisions, the country-by-country reporting, even the master file of transfer

\(^{20}\) Jeffrey Owens, *Tax Transparency and BEPS*: Keynote speech to the Tax Administration Research Centre Workshop, held at the University of Exeter, 21-22 April 2015, at 8 (emphasis added).
pricing. There are those that look at substance: this whole idea that, if a tax scheme doesn’t have substance behind it, then somewhere something’s gone wrong. … And then, the third theme that runs through the whole programme is coherence. We need a greater coherence in the way that different parts of the international tax system interact.”

In terms of the status of the HKSAR’s BEPS action plan implementation, the following table (Table 2) outlines an assessment from the Big 4 accounting firm Deloitte, which is supplemented through further analysis by the writer. It has been updated to May 2017.21

Table 2: The HKSAR’s OECD BEPS Readiness (Updated)

<table>
<thead>
<tr>
<th>Action</th>
<th>OECD Categorisation</th>
<th>Notes on local country implementation</th>
<th>Expected timing</th>
</tr>
</thead>
<tbody>
<tr>
<td>VAT on business to customers digital services (Action 1)</td>
<td>Common approach</td>
<td>The HKSAR does not impose VAT. The IRD intends to issue a DIPN on the digital economy</td>
<td>Not yet known</td>
</tr>
<tr>
<td>Hybrids (Action 2)</td>
<td>Common approach</td>
<td>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.</td>
<td>Expect mid 2017</td>
</tr>
<tr>
<td>Legislation was passed into law on 26 May 2016</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CFCs (Action 3)</td>
<td>Best practice</td>
<td>As the HKSAR has a source-based tax system and does not tax dividends, not specific rules are expected.</td>
<td>N/A</td>
</tr>
<tr>
<td>Interest deductions (Action 4)</td>
<td>Common approach</td>
<td>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.</td>
<td>Not yet known</td>
</tr>
<tr>
<td>Harmful tax practices (Action 5)</td>
<td>Minimum standard</td>
<td>The IRD will review and amend provisions found to be harmful, and consider mandatory spontaneous EOI on certain rulings.</td>
<td>Not yet known</td>
</tr>
<tr>
<td>Prevent treaty abuse (Action 6)</td>
<td>Minimum standard</td>
<td>The IRD will consider whether an applicant would be entitled to benefits under a treaty when processing an application for a certificate of residence.</td>
<td>Expect mid 2017</td>
</tr>
<tr>
<td>Permanent establishment status (Action 7)</td>
<td>Revision of existing standard</td>
<td>The IRD will amend the legislation and issue a DIPN to provide more guidance.</td>
<td>Expect mid 2017</td>
</tr>
<tr>
<td>Transfer pricing (Actions 8-</td>
<td>Revision of</td>
<td>The HKSAR has two DIPNs providing</td>
<td>Expect mid 2017</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>10)</th>
<th>existing standard</th>
<th>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.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Measuring and Monitoring BEPS (Action 11)</td>
<td>Common approach</td>
<td>The actions taken under CbC (Action 13) are to complement the economic analysis of BEPS.</td>
</tr>
<tr>
<td>Disclosure of aggressive tax planning (Action 12)</td>
<td>Best practice</td>
<td>Legislation on automatic exchange of financial account information has been introduced.</td>
</tr>
<tr>
<td>Transfer pricing documentation &amp; CbC reporting (Action 13)</td>
<td>Common approach</td>
<td>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 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.</td>
</tr>
<tr>
<td>Dispute resolution mechanisms effectiveness (Action 14)</td>
<td>Common approach</td>
<td>IRD has indicated that this is one of four priority areas where there are agreed standards with which Hong Kong will cooperate.</td>
</tr>
<tr>
<td>Developing a Multilateral Instrument to modify bilateral tax treaties (Action 15)</td>
<td>Common approach</td>
<td>The HKSAR is looking to ensure it will be able to implement the requirements of this action plan.</td>
</tr>
</tbody>
</table>

As at the time of writing, the HKSAR’s response to a number of the BEPS Actions have yet to be publicly released. One recent release has been the HKSAR’s decision to extend the application of the Multilateral Convention to the HKSAR. The HKSAR has identified that while a bilateral approach could be adopted for implementing the BEPS Actions, this has become increasingly impractical given the continued enlargement in the scope of tax information exchanges internationally.

Upon the request of Hong Kong, the Central Peoples Government (CPG) in the PRC has given in-principle approval to extend the application of the Multilateral Convention to the HKSAR. The HKSAR Government proposes that by amending the Inland Revenue Ordinance (Cap. 112), the

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22 LegCo, Application of the Multilateral Convention on Mutual Administrative Assistance in Tax Matters in Hong Kong LC Paper No. CB(1)1030/16-17(08) (May 2017).
HKSAR will be covered by the Multilateral Convention so that it can provide a platform for the exchange of the necessary information with parties under AEOI and BEPS. The HKSAR Government intends to take forward the mandatory provisions of the Multilateral Convention while making suitable reservations/declarations for the optional provisions so that such provisions will not apply (or partially apply) to the HKSAR. The HKSAR Government intends to introduce an amendment bill into LegCo in October 2017 to give effect to this. Upon the enactment, the HKSAR will seek the CPG’s assistance to deposit a declaration for territorial application of the Multilateral Convention to Hong Kong with the OECD, together with the reservations and declarations applicable to the HKSAR.

In relation to a request for what the HKSAR is planning with respect to its BEPS and associated international tax efforts, the Acting Secretary to the FSTB (James Lau) wrote on 24 May 2017:

“(1) So far, Hong Kong has signed bilateral CAAs with 11 jurisdictions, namely Belgium, Canada, Guernsey, Italy, Japan, Korea, Mexico, the Netherlands, Portugal, South Africa and the United Kingdom, for implementing AEOI from 2018. As an on-going effort to expand our AEOI network, we are also conducting bilateral CAA negotiations with over 30 jurisdictions.

(2) and (3) At present, Hong Kong is not covered by the Multilateral Convention and adopts a bilateral approach in the implementation of AEOI. Experience gained in the past year shows that bilateral CAA negotiations with individual jurisdictions take relatively more time.

We note that among the 100 jurisdictions committed to AEOI, 90 have participated in the Multilateral Convention (either as a signatory or as a territory covered by way of territorial extension). We are actively considering the possibility of extending the application of the Multilateral Convention to Hong Kong so as to expand our AEOI network more quickly. We plan to brief the Panel on Financial Affairs of the Legislative Council on the latest developments in June this year.”

4. THE OECD’S MULTILATERAL INSTRUMENT

The key component of BEPS Action 15 is the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the Multilateral Instrument). The purpose of the Multilateral Instrument is to speedily implement the tax treaty-related BEPS measures. In order to do this, the instrument is intended to enable all parties to meet the treaty-related minimum standards that were agreed as part of the final BEPS package (including the

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minimum standard for the prevention of treaty abuse under Action 6 and the minimum standard for the improvement of dispute resolution under Action 14). The Multilateral Instrument operates to modify CDTAs between two or more parties to the Multilateral Instrument. However, it will not function in the same way as an amending protocol to a single existing treaty, which would directly amend the text of the Covered Tax Agreement (CTA). Rather, the Multilateral Instrument will be applied alongside existing CDTAs, modifying their application in order to implement the BEPS measures.24

To date, over 100 jurisdictions (including HKSAR) developed the draft, which has as its overall goal to allow participating jurisdictions to swiftly and efficiently adopt supplemental or substitute provisions without having to re-negotiate each bilateral treaty separately.25 As a consequence it will:

- Transpose results from BEPS into around 3,000 CDTAs;
- Allow governments to strengthen their tax treaties with the other tax treaty measures developed in BEPS;
- Provide flexibility with respect to ways of meeting BEPS minimum standards on treaty abuse and dispute resolution;
- Offer possibility to opt out from provisions which do not reflect a BEPS minimum standard; and
- Offer possibility to apply optional provisions and alternative provisions where there are multiple ways to address BEPS.

The Multilateral Instrument will only apply if specifically listed as a CTA in a notice to the OECD and supplements, rather than replace analogous provision of a CTA. The key components of the Multilateral Instrument are:

- Prevention of treaty abuse and limitation on benefits
- Avoidance of permanent establishment status (agent arrangements, specific activity exemptions, and split contracts)


25 As at 10 May 2017, there were 107 member countries and 4 observer jurisdictions (which includes the HKSAR).
• Hybrid mismatch arrangements and hybrid entities
• Definition of “residence” and tie-breaker provisions
• Adjustments to the application of double taxation to prevent double non-taxation
• Related party dividend transactions
• Capital gains related to real property
• Improved dispute resolution, corresponding adjustments, and arbitration

Table 3 sets out the key components of the Multilateral Instrument, including the article in which they appear and a brief description of their contents.
Table 3: Outline of the Content of the Multilateral Instrument

<table>
<thead>
<tr>
<th>Section</th>
<th>Relevant Article(s)</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Title and preamble</td>
<td></td>
<td>Sets out the context and purpose of the MLI.</td>
</tr>
<tr>
<td>Part I: Scope and Interpretation of Terms</td>
<td>1 to 2</td>
<td>Governs application of the MLI and defines key terms including Covered Tax Agreement.</td>
</tr>
<tr>
<td>Parts II – V: Substantive BEPS measures</td>
<td>3 to 17</td>
<td>Contains the operable clauses on hybrid mismatches, treaty abuse, PE avoidance, and improved Mutual Agreement Procedure (MAP). Each operative clause has a corresponding compatibility clause, reservation clause and notification clause. Some articles also permit choices between alternative clauses. This structure is explained further below.</td>
</tr>
<tr>
<td>Part VI: Arbitration</td>
<td>18 to 26</td>
<td>Contains a framework for independent binding arbitration.</td>
</tr>
<tr>
<td>Part VII: Final provisions</td>
<td>27 to 39</td>
<td>Contains mechanical provisions including those governing signature, ratification, amendment, notifications, language, entry into force and entry into effect.</td>
</tr>
</tbody>
</table>

One important issue is what will be the role of explanatory statements. Will they have the status of ‘context,’ or maintain (lower level) status quo of Commentaries to the OECD’s Model Tax Convention? The language and implementation process are also significant. A further issue yet to be made clear is how will developing countries act, and in particular, will they seek to follow the United Nations’ Model Tax Convention?

The first high-level signing occurred on 7 June 2017 in Paris, France, with 68 jurisdictions signing the agreement. The Multilateral Instrument comes into force once five countries ratify, which should occur by late 2017. The HKSAR is one of these signatories at the ceremony on 7 June 2017.

5. A POST-BEPS WORLD

With BEPS fully entrenched as part of the global tax scene, what can we expect to see in a post-BEPS world? Tax cooperation is the new norm, with the consequences of years of jurisdictions

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26 See Stéphane Austry (France), John Avery Jones (United Kingdom), Philip Baker (United Kingdom), Peter Blessing (United States), Robert Danon (Switzerland), Shefali Goradia (India), Koichi Inoue (Japan), Jürgen Lüdicke (Germany), Guglielmo Maisto (Italy), Toshio Miyatake (Japan), Angelo Nikolakakis (Canada), Kees van Raad (the Netherlands), Richard Vann (Australia) and Bertil Wiman (Sweden), “The Proposed OECD Multilateral Instrument Amending Tax Treaties” (2016) 70(12) Bulletin for International Fiscal Documentation 683-689.

27 United Nations, Model Double Taxation Convention between Developed and Developing Countries (2011).
facilitating tax competition necessitating the move to this new environment. Greater disclosures by taxpayers, especially MNEs, is a major consequence mandated to facilitate enhanced exchange of information between jurisdictions.

There are expected to be further amendments to the OECD’s Transfer Pricing Guidelines to reflect the changes from BEPS. The latest version was finalised in 2010. Furthermore, the minimum standards and recommendations in the various BEPS reports will need implementation. One major unanswered question is whether all jurisdictions will ‘comply’, as not all have declared their intentions at this time. Work remains ongoing in some areas, which will necessitate further monitoring and concerned energy from jurisdictions; however, will this be forthcoming? Within the BEPS initiatives, will non-OECD member countries continue to be involved in the process going forward?

A related issue with particular importance in the EU is its focus on State Aid rules. Of relevance to the HKSAR is whether this will expand more widely? Couples with this is the observation that unilateral action happening in some areas: for example, the diverted profits tax by Australia and the UK. What is not clear is how many other countries may go down this path, including developing countries? ‘Pushbacks’ and ‘lobbying’ from MNEs, especially in domestic ratification through the consultation process is expected once ratification of BEPS initiatives are undertaken through domestic legislative reform.

With BEPS comes a number of ‘new’ concepts such as the “spirit of the law”, “economic substance” and “value creation”. As a consequence tax mitigation and the structuring of companies’ businesses will have to take into account a larger number of variables and a different set of risks. As a consequence tax and tax governance will be major issue to be considered by company boards of directors.

Writing in 2016, Panayi concludes:

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28 State Aid is defined as an advantage in any form whatsoever conferred on a selective basis to undertakings by national public authorities. Therefore, subsidies granted to individuals or general measures open to all enterprises are not covered by this prohibition and do not constitute State aid (examples include general taxation measures or employment legislation). See http://ec.europa.eu/competition/state_aid/overview/index_en.html.

29 On 1 July 2017, the Australian Government proposes to apply a diverted profits tax (DPT) (popularly known as a ‘Google tax’). This tax will apply where companies shift profits offshore through arrangements with related parties in jurisdictions with lower corporate tax rates than apply in Australia. This proposal is broadly based upon similar legislation introduced in the UK in 2015.

“Certainly the implementation of the BEPS Package was never going to be an easy task, notwithstanding the OECD’s ‘grand’ gesture to aim for more inclusiveness. The fact that out of the 15 Action items, only a few proposals have translated into more concrete political commitments and the rest are mere recommendations or best practices, suggests that the OECD is keeping the barge pole rather low. To an extent, the final outcomes suggest that the OECD is not expecting uniformity in most areas and is willing to accommodate several approaches. This raises systemic challenges for international tax law and prolongs its inherent structural weaknesses. It inevitably leads to unilateralism and fragmentation – arguably, more structured unilateralism and fragmentation, but still, the same phenomena that the OECD sought out to address at the launch of the BEPS project. Moreover, some of the proposals (e.g. the menu of options for CFCs or the interest deductibility rules) are likely to generate more tax competition rather than less.”

Kadet concludes his analysis by stating:31

“Given the OECD’s decision to not consider wholesale changes, there will likely be continued calls for a longer-term solution that changes the current environment and reduces the inherent, strong motivation for MNE managements to conduct BEPS activities. This will be especially true if tax base erosion continues through BEPS activities that are only slightly abated from their current level. That would make the two-year BEPS project only the first small step in a longer story.”

Other major BEPS initiatives that will affect the HKSAR include the Spontaneous Exchange of Tax Rulings and CbCR. The effect operation of AEOI will support the HKSAR as it meets its CbCR obligations. Safeguards to ensure the protection of privacy will need to be closely monitored.

One overarching question is “What if this is not enough; that is, BEPS proves to be ineffective?” How will the OECD and the various jurisdictions respond? Even if BEPS appears to (temporarily) resolve the issue, this will not necessarily mean the BEPS Actions are a success. Developing new measures is one thing, ratification is another, along with a real change in MNE behaviour, and jurisdictions making effective use of this enhanced coordination. Time will provide an answer to these questions. The OECD/G20’s BEPS project is certainly not panacea for resolving the issues that the BEPS project has identified. In fact, there is a risk that the costs of BEPS and the

compliance costs generated from some of the actions might far exceed any additional revenue that the governments might collect.

Other issues that will need to be addressed are what will happen to the TIEAs going forward? There are a similar number of such agreements to CDTAs. BEPS does not make specific reference to what changes will be needed to these agreements.

Overall, the Multilateral Instrument is perhaps the biggest test of practical implementation of BEPS – this will become clearer in the second half of 2017 once it has sufficient signatories to be operative. In reality, very few substantive norms of CDTAs are affected by BEPS, but the Multilateral Instrument could revolutionise tax treaty law if it proves effective (updating and implementation are examples). Overall, the change in domestic laws via ratification will be unprecedented with the implementation of BEPS into domestic law in participating jurisdictions.

6. CONCLUDING OBSERVATIONS

There have been rapid developments in the HKSAR since Global Forum’s Peer Review in its 2013 Report. These developments include: TIEAs, Model 2 IGA under FATCA, further CDTAs, paving the way to becoming a party to Multilateral Convention ensuring AEOI facilities are in place, and being active in BEPS (supporting 4 areas of minimum standards, joined as an Associate member, worked on Multilateral Instrument).

Going forward the HKSAR needs an enhanced transfer pricing regime, with more stringent documentation. It also needs to create an APA facility. In order to give effect to this, the HKSAR Government intends to introduce draft legislation in first half of 2017. The HKSAR Government signed the Multilateral Instrument at the 7 June 2017 signing ceremony.

Now that we are moving into a post-BEPS world, the ‘hard work’ is to come with domestic ratification, and application of the various BEPS Actions. Importantly BEPS is not the end but part of a journey. Just how this journey unfolds and where it takes us will become clearer over the next couple of years.

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. It appears that the PRC takes the lead while the HKSAR may request the PRC to give effect to ratification on its behalf.
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 but exciting times for the HKSAR from a tax perspective.