

Bills Committee on Inland Revenue (Amendment) Bill 2016
Follow-up to the meeting on 2 February 2016

Purpose

At the meeting on 2 February 2016, Members raised questions on due diligence procedures and self-certifications under the arrangements of automatic exchange of financial account information in tax matters (“AEOI”). The Government’s response is set out in this paper.

Due diligence procedures

2. The Common Reporting Standard (“CRS”) promulgated by the Organisation for Economic Cooperation and Development (“OECD”) has incorporated a set of unified due diligence procedures. Each jurisdiction has to require its reporting financial institutions (“RFIs”) to conduct various due diligence procedures, in accordance with the relevant requirements, for their pre-existing individual accounts, new individual accounts, pre-existing entity accounts and new entity accounts¹, so as to identify reportable accounts held by residents for tax purposes of reportable jurisdiction and to collect reportable information of the relevant accounts.

3. The Inland Revenue (Amendment) Bill 2016 (“the Bill”) adds a new Schedule 17D, which has incorporated the due diligence procedures under CRS. Apart from certain textual amendments and format changes having regard to the need of domestic legislation or the long sentence structure in the original text, the content in general is no different from CRS. Meanwhile, we have set out the operation dates in relevant

¹ If the account holder is an entity, that entity account will become a reportable account under the following circumstances –

- (a) The entity is a resident for tax purposes in a reportable jurisdiction. For instance, the entity is constituted under the laws of the reportable jurisdiction, or is normally managed or controlled in the reportable jurisdiction; and
- (b) The entity falls within the definition of “passive NFE”, and even if the entity itself is not a resident for tax purposes in a reportable jurisdiction, at least one of its controlling persons is a resident for tax purposes in a reportable jurisdiction. Generally speaking, a passive NFE is an entity, in the relevant year, with 50% or more of its income being passive income or with 50% or more of its assets producing or being held for the production of passive income; and a specified investment entity which is not in a participating jurisdiction.

provisions.

4. In order to fulfil our international commitment to commence the first automatic exchanges by the end of 2018, we look forward to the passage of the Bill within the current legislative term to implement the relevant legal framework, and that we can sign an AEOI agreement with at least one jurisdiction and bring the agreement into effect. As such, RFIs in Hong Kong can start to implement the due diligence procedures on 1 January 2017. The relevant procedures can in general be classified into two types –

- (a) **New accounts** (i.e. opened on or after 1 January 2017): RFIs have to request individual and entity account holders to submit self-certifications. Account holders have to provide information regarding their own tax residence, so that RFIs are able to verify whether the accounts are reportable accounts. According to CRS, the **onus of ascertaining tax residence rests with the account holders**.
- (b) **Pre-existing accounts** (i.e. opened before 1 January 2017): CRS has set out the required procedures for identifying whether the account holder is a resident for tax purposes in a reportable jurisdiction regarding **low value individual accounts, high value individual accounts, low value entity accounts and high value entity accounts** respectively. In gist, CRS has provided for more stringent requirements for high value pre-existing accounts. For instance, regarding **low value individual accounts**, an RFI has to identify whether the account holders are residents for tax purposes of a reportable jurisdiction having regard to the current residence address for the account holders in its records based on documentary evidence; or review electronically searchable data maintained by the RFI to find out certain indicia stipulated in CRS (such as the identification of the account holder as a resident for tax purposes of a reportable jurisdiction, whether the telephone number or current residence address is within a reportable jurisdiction, etc.) to identify if the accounts are reportable accounts. As for **high-value individual accounts**, apart from electronic record search and paper record search, RFIs is also

required to conduct the identifying procedures through relationship manager inquiry for actual knowledge test. In case there is anything unclear, RFIs can request account holders of low value or high value individual accounts to provide self-certifications.

The summary of the relevant due diligence procedures of various types of accounts is set out in **Annex**.

5. In fact, under the existing Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615), FIs are required to conduct due diligence for their customers, so as to identify and verify the customers' identity. In order to reduce the compliance burden of RFIs in carrying out the due diligence procedures for AEIOI, **CRS allows RFIs to resort to information collected pursuant to such procedures** for the purpose of identifying or ascertaining the tax residence of the account holders. The new Schedule 17D in the Bill has reflected the relevant arrangement. To be more specific, having regard to the views expressed by FIs during the consultation period, if RFIs have already collected certain residence proof information of their customers in accordance with the existing AML/KYC procedures and that information shows updated residence addresses of the customers, RFIs can continue to seek and rely on such information to identify the tax residence of their customers, and there is no need to request customers to separately provide other types of residence proof.

Self-certifications

6. As shown in paragraph 4 above, self-certification is an important tool under CRS for RFIs to determine the tax residence of their account holders, so as to fulfill their reporting and due diligence obligations. However, we must emphasize that **CRS does not expect RFIs to carry out independent legal analysis of relevant tax laws or carry out investigation to determine the tax residence of the account holders, but only to perform a reasonableness test of the self-certification**. As demonstrated in the Commentary of CRS, the essence of the reasonableness test is that RFIs need to verify the information of the

self-certification with reference to the information collected when opening accounts. Should any part of the self-certification be apparently in conflict with the information as held by FIs, new self-certification or explanation from the account holder should be sought.

7. The proposed penalty under the Bill for making a self-certification that is false, misleading and incorrect in a material particular (i.e. level 3 fine) is considered necessary and appropriate, because –

(a) **We have to ensure effective implementation of AEOI.** Section IX of CRS sets out that a jurisdiction must have rules and procedures to ensure effective implementation of AEOI. The Commentary of CRS also states that jurisdictions are expected to include a specific provision in their domestic law imposing sanctions for signing a false self-certification, so as to increase the reliability of self-certification. Other jurisdictions (such as Australia and the Netherlands) have also provided for penalty provisions for account holders providing false or incorrect self-certification.

(b) **The penalty has to comply with specified conditions.** The penalty is only applicable in the following circumstances when an account holder makes a self-certification –

- (i) the account holder makes a statement that is misleading, false or incorrect in a material particular; and
- (ii) the account holder knows, or is reckless as to whether, the statement is misleading, false or incorrect in a material particular.

(c) **The penalty is proportionate to similar penalties under the existing Inland Revenue Ordinance (“IRO”).** We have made reference to the existing penalties under IRO, including section 80(2D), which is about providing incorrect information in relation to a government of a territory outside Hong Kong with which we have entered into an arrangement having effect under

section 49(1). If convicted, the person concerned will be fined and the penalty level is also at level 3.

8. Furthermore, in response to the issues raised by Members at the meeting, we would like to provide the following information –

- (a) There are similar provisions in other local legislation (e.g. sections 413(3) and (4) of the Companies Ordinance (Cap. 622)²) that if a person provides information to another person (not Government) and the statement of which is misleading, false or deceptive in a material particular, and the information provider knows or is reckless as to whether the statement is misleading, false or deceptive in a material particular, and such information is required by that another person in accordance with the relevant ordinances, the person providing information commits an offence.
- (b) In order to facilitate the operation of RFIs, the Inland Revenue Department will provide samples of self-certifications for FIs' reference. For the sake of facilitating account holders to clearly know about the penalties for providing misleading, false or incorrect in a material particular in self-certifications, we will liaise with relevant FI groups and suggest that they should remind account holders of the possible consequences as appropriate.
- (c) The provision concerning account holders providing misleading, false or incorrect self-certification in a material particular will be added to section 80 of IRO. At present, an offence under section 80 of IRO is not a recordable offence. Hence, the proposed offence will not be a recordable one. In fact, we have no plan to

² According to section 413(3) of the Companies Ordinance, if –
(a) the person makes a statement to an auditor of a company that conveys or purports to convey any information or explanation that the auditor requires, or is entitled to require, under section 412(2) or (4);
(b) the statement is misleading, false or deceptive in a material particular; and
(c) the person knows that, or is reckless as to whether or not, the statement is misleading, false or deceptive in a material particular,
the person commits an offence.

According to section 413(4), A person who commits the above is liable—

- (a) on conviction on indictment to a fine of \$150,000 and to imprisonment for 2 years; or
- (b) on summary conviction to a fine at level 5 and to imprisonment for 6 months.

make the proposed offence the conviction of which be recorded.

Financial Services and the Treasury Bureau
February 2016

Due diligence procedures provided in the new Schedule 17D

(The table below only provides a summary of the due diligence procedures.

For the full set of due diligence procedures which will have legal effect,
please refer to the new Schedule 17D set out in the Bill.)

	Pre-existing accounts (opened before 1 January 2017)	New accounts (opened on or after 1 January 2017)
Individual accounts	<p><u>Low value accounts (below or equal to HK\$7.8 million)</u></p> <ul style="list-style-type: none"> ● Residence address test: If in RFI's records having a current residence address for an account holder with documentary evidence, the RFI may treat that account holder as a resident for tax purposes of the jurisdiction. ● Electronic record search: If a RFI does not rely on the residence address test, it must review electronically data maintained by itself for any of the following indicia – <ul style="list-style-type: none"> (a) identification of the account holder as a resident for tax purposes of a reportable jurisdiction; (b) current mailing or residence address (including a post office box) in a reportable jurisdiction; (c) one or more telephone numbers in a reportable jurisdiction outside Hong Kong with no telephone number in Hong Kong; 	<ul style="list-style-type: none"> ● To obtain self-certification when opening accounts ● Relied on information obtained during account opening (including relied on information collected pursuant to AML/KYC procedures) so as to ascertain if the self-certification is reasonable

	Pre-existing accounts (opened before 1 January 2017)	New accounts (opened on or after 1 January 2017)
	<p>(d) standing instructions (other than with respect to a depository account) to transfer funds to an account maintained in a reportable jurisdiction;</p> <p>(e) currently effective power of attorney or signatory authority granted to a person with an address in a reportable jurisdiction;</p> <p>(f) a hold mail instruction or in-care-of address in a reportable jurisdiction if the RFI does not have any other address on file for the account holder.</p> <ul style="list-style-type: none"> ● If electronic search is conducted and no indicium above is discovered, no further action is required. ● If any indicia described in (a), (b), (c), (d) and (e) is discovered in the electronic search, the RFI must treat the account holder as a resident for tax purposes of the reportable jurisdiction for which an indicium is identified. If there is anything unclear in the indicia, the RFI may request account holders to provide self-certification and documentary evidence. If the relevant procedures establish that the account holder is not a resident for tax purposes in a reportable jurisdiction, the RFI need not treat 	

	Pre-existing accounts (opened before 1 January 2017)	New accounts (opened on or after 1 January 2017)
	<p>that account holder as a resident for tax purposes in a reportable jurisdiction.</p> <ul style="list-style-type: none"> ● If a hold mail instruction or in-care-of address is discovered in the electronic search and no other address and none of other indicia is identified for the account holder, the RFI must perform the paper record search or request the account holder to provide self-certification or documentary evidence. If the RFI has conducted the relevant procedures but is unable to establish an indicium and unable to obtain any self-certification or documentary evidence, the RFI must report the account as an undocumented account. ● The review procedures must be completed on or before 31 December of the reporting year for the account (For example, Hong Kong signs an AEOI agreement with Country A and both will exchange information in 2020. RFIs in Hong Kong have to complete the relevant due diligence procedures before 31 December 2020, so as to identify if any account holders of low value pre-existing accounts are residents for tax purposes in Country A). 	

	Pre-existing accounts (opened before 1 January 2017)	New accounts (opened on or after 1 January 2017)
	<p><u>High value accounts (exceeding HK\$7.8 million)</u></p> <ul style="list-style-type: none"> ● Electronic record search: i.e. the electronic record search for low value accounts mentioned above. ● Paper record search: If RFI's electronically searchable databases do not capture all the following information, the RFI must review documents associated with that account and obtained by the RFI within the last five years – <ul style="list-style-type: none"> (a) the account holder's residence status; (b) the account holder's mailing and residence address currently on file with the RFI; (c) the account holder's telephone number currently on file, if any, with the RFI; (d) for financial accounts other than depository accounts, whether there are standing instructions to transfer funds in the account to another account (including an account at another branch of the RFI or another FI); (e) whether there is a current hold mail instruction or in-care-of address for the account holder; (f) whether there is any power of attorney or signatory authority for the account. 	

	Pre-existing accounts (opened before 1 January 2017)	New accounts (opened on or after 1 January 2017)
	<ul style="list-style-type: none"> ● Relationship manager inquiry for actual knowledge: Apart from the electronic and paper record searches, the RFI must treat as a reportable account any high value account assigned to a relationship manager of the RFI if the relationship manager has actual knowledge that the account holder is a reportable person. ● If electronic and paper record searches are conducted and no indicium above is discovered and the account is not identified by the relationship manager as held by a reportable person, no further action is required. ● If any indicia described in (a), (b), (c), (d) and (e) is discovered in the search, the RFI must treat the account holder as a resident for tax purposes of the reportable jurisdiction for which an indicium is identified. If there is anything unclear in the indicia, RFIs may request account holders to provide self-certification and documentary evidence. If the relevant procedures establish that the account holder is not a resident for tax purposes in a reportable jurisdiction, RFIs need not treat that account holder as a resident for tax purposes in a reportable 	

	Pre-existing accounts (opened before 1 January 2017)	New accounts (opened on or after 1 January 2017)
	<p>jurisdiction.</p> <ul style="list-style-type: none"> ● If a hold mail instruction or in-care-of address is discovered in the search and no other address and none of other indicia is identified for the account holder, the RFI must request the account holder to provide self-certification or documentary evidence. If the RFI is unable to obtain any self-certification or documentary evidence, the RFI must report the account as an undocumented account. The RFI has to reapply the relevant review procedures annually until the account cease to be undocumented. ● The review procedures must be completed on or before 31 December of the year before the reporting year for the account (For example, Hong Kong signs an AEOI agreement with Country A and both will exchange information in 2020. RFIs in Hong Kong have to complete the relevant due diligence procedures before 31 December 2019, so as to identify if any account holders of high value pre-existing accounts are residents for tax purposes in Country A). 	

	Pre-existing accounts (opened before 1 January 2017)	New accounts (opened on or after 1 January 2017)
Entity accounts	<p><u>Aggregate account balance below or equal to HK\$1.95 million</u></p> <ul style="list-style-type: none"> ● Unless RFIs elect to review the relevant accounts, if the aggregate account balance or value does not exceed \$1.95 million as at 31 December of the second year before the reporting year, RFIs need not review such accounts (For example, Hong Kong signs an AEOI agreement with Country A and both will exchange information in 2020. RFIs in Hong Kong have to base on the aggregate account balance or value of the relevant accounts as at 31 December 2018 to determine whether the accounts need to be reviewed. If the aggregate account balance or value does not exceed \$1.95 million, there is no need to review). <p><u>Aggregate account balance exceeds HK\$1.95 million</u></p> <ul style="list-style-type: none"> ● RFIs must review information maintained for regulatory or customer relationship purposes (including information collected and maintained pursuant to AML/KYC procedures) to determine the account holders' residence. If the information indicates that the account holder is a 	<ul style="list-style-type: none"> ● To obtain self-certification when opening accounts to determine if the entity is a resident for tax purposes of a reportable jurisdiction ● Relied on information obtained during account opening (including relied on information collected pursuant to AML/KYC procedures) so as to ascertain if the self-certification is reasonable ● RFIs have to seek self-certifications from account holders of new entity accounts, so as to determine if the account holder is a passive NFE. ● If the entity is a passive NFE, RFIs have to rely on information collected and maintained pursuant to AML/KYC procedures to

	Pre-existing accounts (opened before 1 January 2017)	New accounts (opened on or after 1 January 2017)
	<p>reportable person, the RFI must treat the account as a reportable account unless the RFI obtains a self-certification from the account holder, or reasonably determines, based on information in its possession or that is publicly available, that the account holder is not a reportable person.</p> <ul style="list-style-type: none"> ● RFI must obtain a self-certification from the account holder to determine whether the account holder is a passive NFE. ● If the entity is a passive NFE, a RFI has to rely on information collected and maintained pursuant to AML/KYC procedures to determine the controlling persons of an account holder, and rely on the following information to determine the residence of the controlling person – <ul style="list-style-type: none"> (a) in case of a pre-existing entity account held by one or more passive NFEs with an aggregate account balance or value that does not exceed HK\$7.8 million, the RFI may rely on information collected and maintained pursuant to AML/KYC procedures; or 	<p>determine the controlling persons of the account holder, and rely on the self-certifications from the relevant account holders or controlling persons to determine the tax residence of the controlling persons.</p>

	Pre-existing accounts (opened before 1 January 2017)	New accounts (opened on or after 1 January 2017)
	<p>(b) a self-certification from the relevant account holder or controlling person.</p> <ul style="list-style-type: none"> ● If the aggregate account balance or value exceeds HK\$1.95 million as at 31 December of the second year before a reporting year, the review must be completed on or before 31 December of the reporting year (For example, Hong Kong signs an AEOI agreement with Country A and both will exchange information in 2020. RFIs in Hong Kong have to base on the aggregate account balance or value of the relevant accounts as at 31 December 2018 to determine whether the accounts need to be reviewed. If the aggregate account balance or value exceeds \$1.95 million, the due diligence procedures must be completed before 31 December 2020 to identify if any account holders of these pre-existing accounts are residents for tax purposes in Country A). ● If the aggregate account balance or value does not exceed HK\$1.95 million as at 31 December of the second year before a reporting year, but exceeds HK\$1.95 million as at the last day of a subsequent calendar year, the review must 	

	Pre-existing accounts (opened before 1 January 2017)	New accounts (opened on or after 1 January 2017)
	<p>be completed within the calendar year following the year in which the aggregate account balance or value exceeds HK\$1.95 million (For example, Hong Kong signs an AEOI agreement with Country A and both will exchange information in 2020. RFI in Hong Kong have to base on the aggregate account balance or value of the relevant accounts as at 31 December 2018 to determine whether the accounts need to be reviewed. If the aggregate account balance or value does not exceed \$1.95 million at that time, but the amount exceeds as at 4 March 2020, the RFI has to complete the due diligence procedures before 31 December 2021 to identify if any account holders of these pre-existing accounts are residents for tax purposes in Country A).</p>	