



Ref: Lv008/16

23 February 2016

**By Fax (3529 2837) and Email (mpoon@legco.gov.hk)**

The Hon. Andrew LEUNG Kwan-yuen, GBS, JP  
Chairman  
Legislative Council Bills Committee on Inland Revenue (Amendment) Bill 2016

Dear The Hon. Leung

**Inland Revenue (Amendment) Bill 2016**

Thank you for inviting The Hong Kong Federation of Insurers ("HKFI") to provide comments on the subject Bill.

The HKFI, together with our 46 Member Companies who are Authorized Insurers conducting Long Term Business and constitute over 90% of market share, is supportive of the legislative amendments in relation to the key objectives of the implementation of the new global standard on automatic exchange of information ("AEOI") in Hong Kong.

However, it is critically important that Hong Kong achieves this objective through a workable and economical framework for the industries which are affected, which above all else, is consistent with local legal and regulatory regimes. The insurance industry is currently one of the few industries in Hong Kong that enjoys a high degree of self-regulation complemented by the Government of HKSAR's prudent regulatory framework. In this regard, this letter outlines the HKFI's comments on the key issues raised in the Bill pertinent to AEOI.

We note that our comments are in line with the views expressed by other international or European insurance associations in other AEOI consultations. As you may be aware, most insurance products should have a low risk of being used to evade tax. Unlike other financial industries, the primary relationship with the policyholder often rests with an independent agent or other intermediary and there is limited contact between an insurance company and its policyholders after an insurance policy is sold (until there is a claim or maturity on the policy). As a result, regardless of the jurisdiction, certain due diligence requirements under the AEOI may give rise to disproportionate administrative costs compared to the low level of risk of tax evasion these insurance products present.

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### **(A) Scope of FIs, excluded accounts**

The objective and design of a typical insurance product is very different from the type of business that exchange of information legislation for tax purposes targets. A typical insurance contract is designed to provide financial protection against an unforeseen event, such as flooding, accidents, burglary, death, disability or illness. In this respect, general insurance companies do not create financial accounts and as a result do not accept deposits and do not engage primarily in the business of investing, reinvesting or trading in securities for their policyholders.

Under the current AEOI framework, it is noted that pure property and casualty or general insurance companies will not fall within the definition of Specified Insurance Company and will not therefore fall within the rules. However, composite insurance companies which write both long-term and general insurance business will fall within the definition of Specified Insurance Company meaning that the definition of Financial Accounts needs to clearly exclude general insurance contracts as well as other contracts with no cash value.

Most of the accounts of our Members which have cash value and/or are investment linked are Class A (i.e. life and annuity) and Class C (i.e. linked long term) products as defined under Schedule 1 of the Insurance Companies Ordinance ("ICO"). Although some Class D (i.e. medical reimbursement) products with refundable premium feature may have cash value, the cash value accumulated will not exceed the total premiums paid during the life of the policy. Having considered these, insurance products other than Class A and Class C should be considered as having a low risk of being used to evade tax. To ease the compliance burden for insurance companies in complying with the AEOI framework, we would suggest inclusion of the insurance products other than Classes A and C under the ICO as excluded accounts for AEOI reporting purposes under List of "Excluded Accounts" at Annex B.

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If the entire non-Classes A and C products cannot be excluded, we recommend that all general insurance business as defined under Schedule 1 of the ICO be excluded as such insurance products do not have an investment linked component – which is the reason for the inclusion of insurance products in the AEOI framework – and may be caught within the due diligence and reporting requirements by default, despite a zero practical risk of being used for tax evasion. In particular, the following categories of policies should be excluded from the scope of AEOI as they will not be used for tax evasion:

(i) Reinsurance contracts (life and non-life)

Reinsurance products are business to business transactions sold only to insurance companies. The insurer and not the reinsurer is liable to the policyholder, therefore reinsurance provides no potential investment return to individual natural persons and does not implicate the concerns of tax evasion.

(ii) Property & Casualty (“P&C”) contracts

Such insurance policies are designed to reimburse the insured persons for damages caused by insured events. P&C policies do not resemble investment products. They cover P&C risks that create payments to policyholders and/or to the injured person only when insurable events occur.

(iii) Contracts without Cash Value

Contracts without a cash value only pay out on the happening of an insured event and therefore will not be used as a method of tax evasion. While term life insurance contracts are suggested as one of the excluded accounts, we suggest that the following policies be excluded as well, although this list should not be viewed as exhaustive:

(1) Accident, health, medical and disability policies also pay only when triggered by the occurrence of an insured event. These products do not build up a cash value. These products also can be subscribed by individuals or groups.

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(2) Credit Life Policy – the policyholder and beneficiary is the mortgage lender (usually a bank) and the insured is the mortgage borrower to cover the mortgage repayment obligation. The policyholder may receive the unearned premium upon the cancellation of the insurance contract. The unearned premium received will not exceed the premium contributed.

(3) Group Insurance products – an employer insures its employees for medical and death claim. These products should be excluded as they are not for investment purposes.

#### **(B) Scope of information to be furnished by FIs**

It is not clear in Footnote to section (B)(10)(a) as to whether FIs have to collect TINs post-implementation as this would be a major burden on the industry. We are doubtful if anyone remembers their TIN or has it handy during the sales process. We are also concerned about the requirement for the industry to make reasonable efforts to collect TINs on pre-existing accounts within 2-3 years; this is far from a trivial process. In this regard, we suggest the FIs can rely on the passport number of the individual as an alternative.

#### **(D) Due diligence and reporting requirements & (E) Enforcement provisions - powers and sanctions**

We suggest the guidelines pertinent to self-certification should give more clarity and examples to help FIs understand the expectations on "reasonable efforts" to obtain TIN, date of birth. This is a critical step for FIs which will/may be required to collect TINs for existing accounts within 2-3 years.

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### **Section 50F(3) of the subject Bill**

Section 50F(3) makes reference to the requirement to report a nil balance or value accounts which may be source of additional and important workload in the due-diligence and reporting parts (different from Foreign Account Tax Compliance Act ("FATCA")).

In addition to the above, we would appreciate that the Administration provide clarification on the following items which were suggested in HKFI's submission dated 10 July 2015:

#### **a. Notification requirements**

The proposed AEOI regime would rely on the existing "customer relationship" mechanism between FIs and account holders to update and check information so as to ensure that the information to be exchanged is accurate and updated. As mentioned above, there would be limited contact between an insurance company and its policyholders after a policy is sold until there is a claim or maturity on the policy and a low response rate from policyholders on the subsequent notifications and requests. FIs should be allowed to rely on general notifications to customers on their AEOI practices through their Terms and Conditions and account servicing operations to help ensure information to be reported is accurate and up-to-date. FIs, however, would provide account holders a copy of the information reported, upon request.

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We recommend that any existing and new account holder will be notified that his account information may be exchanged if it is identified that he/she is a tax resident of another reportable jurisdiction, in particular this notification can be part of the Terms and Conditions of a Financial Account (i.e. the insurance product). Account holders will have the right to review their information and correct inaccuracies at any time. However, it would be impractical and inefficient for FIs to be required to send account holders any notification with the specific information to be exchanged. Therefore, the AEOI regime should require general notifications to account holders, whilst they can review and correct their personal and financial data under business as usual practices. FIs, however, would provide account holders a copy of the information reported, upon request.

**b. Controlling person**

The definition of “Controlling Persons” of Passive Non-Financial Entities (“NFEs”) in the AEOI framework does not include specific rules on how to identify Controlling Persons, such as rules regarding the calculation of an indirect interest, aggregation of interests held by related parties, control through an FI, etc. The Hong Kong AEOI on Controlling Persons could be modeled after the FATCA Regulations’ concerning “Substantial US Shareholders” with the applicable adaptations (e.g. the preferred ownership threshold should be 25% and not 10%). Therefore, we recommend that the legislation (or local guidelines) include clear rules regarding who a Controlling Person is in the context of different segments of the Hong Kong financial services industry. The AEOI legislation should include clear rules regarding who is a Controlling Person.

**c. Communication Campaign**

The Hong Kong Government should commence a communication campaign as soon as possible to clearly explain the AEOI requirements, as well as the roles and responsibilities of FIs and account holders.

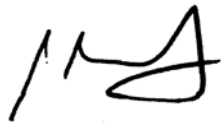
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We once again thank you for the opportunity to share with you our suggestions on this subject and to suggest a practical solution. And we look forward to further dialogue with the Inland Revenue and the Government on the proper way forward. In the meantime, if there is any further information we can provide, please do not hesitate to let us know.

Yours sincerely



Michael Huddart  
Chairman  
Task Force on Automatic Exchange of Financial Account Information ("AEFAITF")  
Life Insurance Council ("LIC")

cc: The Hon. K P Chan, JP  
Mr John Leung, JP, Commissioner of Insurance  
LIC Councillors  
Members of AEFAITF