PWMA Private Wealth Management Association

THE HONG KONG ASSOCIATION OF BANKS 香港銀行公會

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Hon. Andrew LEUNG Kwan-yuen, GBS, JP
Chairman
Bills Committee on Inland Revenue (Amendment) Bill 2016
Legislative Council Complex
1 Legislative Council Road
Central, Hong Kong

Dear Hon. Leung

Submission on the Inland Revenue (Amendment) Bill 2016

The Hong Kong Association of Banks ("HKAB") and Private Wealth Management Association ("PWMA") (collectively referred to as "we") refer to the Inland Revenue (Amendment) Bill 2016 (the "Bill") gazetted on 8 January 2016, and subsequently tabled at the Legislative Council on 20 January. We welcome and thank you for the opportunity to give views on the Bill.

Recognising the global trend towards greater tax transparency, we consider it important for Hong Kong to adopt the OECD Common Reporting Standard ("CRS") for the Automatic Exchange of Financial Account Information ("AEOI"), which would help maintain Hong Kong's status as an international financial centre.

We appreciate that the Hong Kong Special Administrative Region government ("Government") has duly considered the public feedback and suggestions in refining the legislative proposal, and the timely introduction of the Bill. We support the Bill as it seeks to promote a pragmatic and effective CRS regime by offering a framework that, in our view, can be operationalised.

It is imperative that early passage of the Bill can be secured as soon as practicable. Undue delay in the legislative process will be detrimental to the industry's implementation efforts that are underway; and it could also result in adverse impact on the reputation of Hong Kong.

Taxpayers have a key role to play within the AEOI ecosystem. We welcome the initial steps the Government has taken in furnishing AEOI information on the Inland Revenue Department ("IRD") website; however, more needs to be done in explaining the roles and responsibilities of taxpayers and financial institutions ("FIs") pursuant to the CRS due

diligence and reporting requirements in the Bill. We are pleased that the Government has acknowledged the necessity of public education and communication in various forums.

- We are of the view that such campaign(s) should be visible, sustainable, and launched as soon as possible, with a clear timeline that can be shared with the industry within the first half of 2016.
- The campaign may take the form of a number of different media and channels, including but not limited to television broadcasts, newspaper advertisements, posters, printed materials (e.g. brochures, booklets) as well as that are available on agency portals (e.g. GovHK) and in mobile apps.
- Further to creating an IRD AEOI portal for FIs, we submit that the IRD should consider setting up an AEOI/CRS taxpayer hotline.

Drawing from past experience, we believe it is of paramount importance that the industry is able to work with and build upon the Government-led public campaigns when designing, developing and delivering customer communication strategies. All in all, we are of the view that a well thought through Government-led campaign will be a critical success factor in achieving an effective implementation of the CRS in Hong Kong.

While we support the policy and requirements as currently worded in the Bill, we believe that it is crucial for FIs to receive and be able to depend upon further guidance on interpretation of technical matters from the Government. As envisaged in the CRS Commentary, the Government is well positioned to help taxpayers to determine, and provide them with information with respect to, their residence(s) for tax purposes. There is a widespread expectation that the Departmental Interpretation and Practice Notes ("DIPN") to be issued by the IRD would play a pivotal role in helping banks apply, implement and comply with the CRS requirements. A generally high quality implementation outcome from the industry, as a result, could positively influence the OECD Global Forum's peer review on Hong Kong in the near future.

With a view to assisting the Bills Committee, we have set out in the Appendix to this letter the key areas we believe should be addressed in the legislation, guidelines or DIPN, as appropriate. The key areas are as follows:

I. Transitional period relief for FIs in the implementation of the CRS and adoption of a "soft landing" approach to early enforcement and sanctions;
II. Applicability of the OECD issued commentaries, FAQs and technical guidance where this is silent or insufficiently provided for in the legislation (aka the Bill) or DIPN;
III. Adoption of the "wider approach" for new account and preexisting account due diligence without breaching the relevant data privacy laws in Hong Kong;
IV. Alignment of CRS reporting and due diligence requirements with other relevant regulatory requirements (e.g. AMLO) such as definition, treatment of specific types of accounts, etc.;
V. Need for further guidance and specific examples on the "reasonableness test" to be applied to self-certifications obtained from account holders; and

VI. Clarity on the intended implementation approach of the Government in information security to protect the confidentiality of taxpayer's information.

We acknowledge that the Government may have plans or have begun to address the issues we raise in this submission in the DIPN (e.g. guidelines over the "reasonableness test" as discussed with the IRD in previous occasions). We would nevertheless like to suggest that, where practicable, a draft of the DIPN be made available for consultation to help garner wider and further industry support for the AEOI/CRS and to facilitate the Bill's smooth and early passage through the legislative process.

We would be pleased to support the Bills Committee in its consideration of the Bill if required, and will continue to engage with the Government in this matter going forward. Should you have any questions, please do not hesitate to contact Ivy Wong of HKAB Secretariat on 2521-1169.

Yours sincerely

For and on behalf of the Hong Kong Association of Banks

Doris Ma
Secretary

For and on behalf of the Private Wealth Management Association

Joanne Leung
Managing Director

Enclosure:
Appendix - Detailed views and comments on the Bill

c.c. Hon NG Leung-sing, SBS, JP

Appendix - Detailed views and comments on the Bill

We recommend the Government to consider the following refinements.

I. Transitional period relief for FIs in the implementation of the CRS and adoption of a "soft landing" approach to early enforcement and sanctions

The Government may exercise discretionary powers under the Inland Revenue Ordinance over sanctions for CRS non-compliance and such powers would be exercised appropriately on a case-by-case basis. We urge however the legislation recognises the period of 1 January 2017 to 31 December 2018 as a transitional period for the implementation of CRS, and relief be granted to FIs that have made genuine efforts in good faith to comply with the new regulatory requirements. As you would be aware, a similar transitional period relief is provided by the Internal Revenue Service (IRS Notice 2014-33) with respect to the compliance with the US Foreign Account Tax Compliance Act ("FATCA"). We submit that the proposed "soft-landing" approach will recognise bona fide efforts of FIs in dealing with operational challenges and, importantly, help manage and improve customer experience during the course of account due diligence and reporting through sensible (as opposed to overwhelming) policies and procedures.

II. Applicability of the OECD issued commentaries, FAQs and technical guidance ("OEDC CRS Guidance")

We recognise that the Bill generally follows the key aspects of the AEOI standards as promulgated by the OECD with adaptation and reference to the domestic laws where appropriate. However, in situations where specific issues or scenarios addressed in the OECD CRS Guidance are not included in the Bill (e.g. a 90-day grace period to obtain self-certification), it is unclear whether the provisions in the OECD CRS Guidance may be relied upon by FIs in Hong Kong. We appreciate that the legislation and the DIPN cannot cover every conceivable practical issue or operational challenge faced by FIs in Hong Kong – therefore, where the legislation or the DIPN is silent or insufficiently provides for a specific issue or scenario, it would be sensible for FIs to be able to rely on the OECD CRS Guidance instead of having to speculate on the legislative intent or individually seek clarification from the Government.

It is noted that a few jurisdictions that have committed to the AEOI standards, such as the Cayman Islands, have integrated the OECD CRS Commentary into their local regulations. We would propose that Hong Kong FIs be at least permitted to refer to such explanatory materials as long as such reference does not deviate from the spirit of the AEOI standards in Hong Kong, without being considered to have contravened the local law.

III. Adoption of the "wider approach"

We are pleased that the Bill provides the FIs with a clear legal basis to pursue the "wider" approach [1] in identifying and collecting the information in respect of accounts which are not reportable accounts, as the optionality will help address serious operational and cost challenges that FIs would otherwise face.

On the other hand, we would need further guidance and facilitation from the Government as to the adoption of the "wider approach" by FIs in relation to compliance with the relevant data privacy laws in Hong Kong, e.g. the use of Personal Information Collection Statements ("PICS") under the Personal Data (Privacy) Ordinance Cap 486 ("PDPO").

IV. Alignment of due diligence and reporting requirements

We appreciate that the Government recognises the concerns raised by our member banks on the gaps between the requirements under the AEOI and those under other regulatory regimes, including the Hong Kong – US Model 2 Intergovernmental Agreement ("IGA") that facilitates FATCA, Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance ("AMLO") and the relevant guidelines issued by the regulators. We are pleased that the Bill has largely adopted the reporting and due diligence requirements set forth in the OECD CRS, while making provisions provided room for fine tuning of the requirements.

As an example, regarding the percentage threshold for the purpose of determining the controlling person of a passive NFE, the Bill gives the Secretary of the Financial Services and the Treasury Bureau the power to amend the percentage by notice published in the Gazette; some member banks welcome the flexibility. We trust that the Government will consult the industry prior to any official amendments post CRS implementation (i.e. from 1 January 2017), to minimise any potential operational challenges, costs pressure and compliance burden for the FIs specifically in relation to systems, policies and procedures, processes and controls, training, customer experiences, etc.

In addition, we suggest further alignment and clarity be provided in the legislation and/or DIPN to minimise the variations in the CRS regulatory requirements that apply to similar domains e.g. account classification, AML/KYC due diligence. We detail below our view on various issues grouped under due diligence, reporting and definitions.

[1] Please refer to section D(A) under Legislative Proposals in the "LEGISLATIVE COUNCIL BRIEF - Inland Revenue Ordinance (Chapter 112) - INLAND REVENUE (AMENDMENT) BILL 2016".

Due diligence

(a) **Application of residence address test** – the Bill provides an FI with the option to apply the residence address test to preexisting lower value accounts. We would like to seek further clarity on whether such option can be applied to each individual account, i.e. establishing the residence of one account based on the current residence address from the available documentary evidence while performing electronic search for another account when documentary evidence is not available. The reason for this request for clarification is that, under FATCA while FIs have the option to follow the approach under either the IGA or the U.S Treasury Regulations for account due diligence, such an option should be applied to a group of accounts, instead of at the single account level.

(b) **Acceptable documentary evidence** – certain acceptable methods of verifying residential address (e.g. mobile phone bill or pay TV statement) under the existing AML requirements may not meet the definition of acceptable documentation for the residence address test. We understand the Government is prepared to allow FIs to ride on current AML/KYC procedures concerning the supporting documents for the residence address test. We would ask that such alignment be clarified in the DIPN.

(c) **Curing procedures for conflicting indicia** – we note that the curing procedures under Part 3 Subsection 3(8) and (9) of Schedule 17D of the Bill currently does not cover the indicium concerning the identification of an account holder as a tax resident in a reportable jurisdiction pursuant to Subsection 3(3)(a). We would like clarification on the type of document evidence that an FI can obtain from the account holder in order to cure this indicium.

(d) **Review procedures for high value pre-existing individual account holders** –

(i) we would like clarification on the standard of knowledge required for a relationship manager to be considered to possess "actual knowledge" of an account holder being a reportable person pursuant to Part 3 Subsection 4(6) of Schedule 17D of the Bill;

(ii) we note that Part 3 Subsection 4(7)(b) of Schedule 17D of the Bill does not include curing procedure for any "actual knowledge" a relationship manager enquiry, and would like to seek clarification on the applicable curing provision in the Bill.

(e) **Reasonableness test for self-certification** – this "test" is arguably at the heart of the CRS in that it allows FIs to identify reportable persons for reporting and subsequent exchange with AEOI partners. We request further guidance and specific examples be provided to illustrate the expected information verification procedures that will be required for / involved for the "reasonableness test" in determining the reliability of information in the self-certification of an account

holder and how FIs should properly exercise their judgement in complying with such requirements. Examples that illustrate and address specific scenarios will be useful.

(f) **Treatment of account holder who does not provide valid self-certification** –

(i) For new account onboarding, we understand that the Government is willing to consider whether to allow a time period for FIs to collect self-certification, provided mitigation policies and measures are in place. We would welcome affirmative provision in the legislation or guidelines to allow such time period and give FIs more flexibility in implementing mitigation policies and measures. We would also suggest more clarity on whether a new account without a valid self-certification at account opening but identified with any indicia of being a reportable account is required to be reported, if the FI determines that such account is to be closed in accordance with the FI's mitigation policies.

(ii) For preexisting account due diligence and changes in circumstances, where an account holder does not provide a valid self-certification, we would like to seek clarity on (1) the extent to which FIs are required to approach the account holder to obtain self-certification and the relevant time limit; (2) the acceptable handling procedures should the account holder refuse to provide a valid self-certification; and (3) whether FIs are allowed (and are required) to report the account holder's information based on the indicia identified, without breaching the relevant data privacy regulations, such as through adapting the scope of "undocumented account" to include an account holder from which the FI is unable to obtain a valid self-certification after a reasonable number of attempts to do so.

(g) **Account aggregation rule** – we also note that the account aggregation requirements are conditional upon the extent that a Reporting FI's computerized systems link the financial accounts and aggregate the balances or values. More guidance or examples should be provided on the circumstances where aggregation would not be required.

(h) **Currency translation rules** – we note that the dollar amounts in the Bill are denominated in Hong Kong dollars and that Section 5 of Part 7 of Schedule 17D stipulates that a dollar amount is to be read as including an equivalent amount in a foreign currency. However, the Bill is silent on how an amount in a foreign currency should be translated to an equivalent amount in Hong Kong dollars for the purpose of account aggregation in performing due diligence. We would recommend that the legislation or DIPN clarify the appropriate conversion rate to be applied by FIs to translate an amount that is denominated in a foreign currency.

(i) **Collection and reporting of place of birth** – we noted that Section 50F(2) of Part 8A of the Bill requires the place of birth to be included in the return furnished by a Reporting FI in relation to each reportable account. Yet Section 50G(1)(c) states that the place of birth is not required to be reported unless the FI is otherwise required to obtain and report it under the Hong Kong laws and it was available in the electronically searchable data maintained by the FI. From our understanding of the AMLO and other relevant industry guidelines, there is no established requirement for obtaining the place of birth of an account holder in the course of AML/KYC procedures. Therefore, we would like to obtain more clarity on whether place of birth is required to be obtained in the due diligence process for both pre-existing and new accounts and included as information to be reported to the IRD.

(j) **Timeline for completion of due-diligence of pre-existing accounts** – depending on the reporting year as specified by the Commissioner of Inland Revenue pursuant to Schedule 17E, it appears that, if the targeted approach is adopted by a Reporting FI the due diligence deadlines for pre-existing accounts may be phased in based on the time when a jurisdiction enters into an agreement with Hong Kong to exchange information. Where an FI adopts the wider approach, for clarity purposes, it would be helpful if the legislation could stipulate that the FI does not need to conduct any subsequent review after a reportable jurisdiction is added to Schedule 17E, provided that the due diligence of pre-existing accounts has been conducted in accordance with the requirements of the legislation and within the standard time schedule as set forth in Schedule 17D.

Reporting

(k) **Notification to the Commissioner** – the Bill requires FIs to give notice to the Commissioner on "the first occasion on which it commences to maintain a reportable account" (Section 50D(2)). We note that this notification mechanism will be new to FIs in Hong Kong in the context of AEOI, as there is no such requirement under FATCA or the OECD CRS. We recommend the Government to streamline the notification processes with suitable guidelines and timetables so as to provide more clarity to FIs on compliance with the relevant procedural requirements. In particular, for an FI that only maintains pre-existing accounts (i.e., one that no longer accepts new customers), whether this requirement is to be interpreted as the first occasion on which the FI is "aware" that a reportable account is maintained, i.e., upon the completion of due diligence procedures (e.g. by end of 2018) even though the account has been technically "maintained" by the FI since before 2017.

(l) **Nil returns** – concerns are raised with respect to the requirements of filing nil returns, especially when the notification requirements are taken into account. For certain small scale local FIs, adaptation to electronic filing may be an operational challenge. In view of this, we would like to seek clarification on

whether a simpler way of filing a nil return, such as in paper form (as allowed in Singapore for FATCA nil return filing), may be allowed.

(m) **Return filing for account holders with multiple jurisdictions of tax residence** – members are concerned about the current ambiguity regarding reporting of a reportable account that has been identified with multiple jurisdictions of tax residence, in particular whether the reporting FI would need to file one return per reportable jurisdiction of residence or one return per account holder and include all reportable tax residencies of the account holder in a single record. According to the OECD CRS User Guide, each jurisdiction may allow either basis of return filing. Given the Bill does not specify this point, we would suggest the Government to allow FIs to adopt the approach of one return per reportable jurisdiction of residence.

Definitions

(n) **Alignment of the scope of beneficiary(ies) of a trust** – it is noted that according to the Bill the scope of the beneficiary(ies) as the controlling person of a trust that is a passive NFE includes both discretionary and mandatory beneficiary(ies), regardless of whether a distribution is made during the year; whereas for a trust that is an FI, discretionary beneficiary(ies) will only be considered as the account holder during the year when a distribution is made. We are concerned about the practical confusion and challenges arising from such distinctions. In this regard the OECD Commentary provides an option for a jurisdiction to allow FIs to align the scope of the beneficiary(ies) of a trust treated as Controlling Person(s) of the trust that is a Passive NFE with that of beneficiary(ies) of a trust treated as Reportable Persons of a trust that is a FI, in which case the FIs would only need to report discretionary beneficiaries as Controlling Persons of a trust that is a Passive NFE in the year in which they receive a distribution from the trust. Such an option is given on the condition that the Reporting FI must have appropriate safeguards and procedures in place to identify whether a distribution is made by their trust account holders in a given year. We recommend that the option be allowed in the legislation or the DIPN.

(o) **"Management" test for the definition of an investment entity** – we would like to seek clarification on how to define whether an entity is considered to be managed by another entity in order to determine if the first entity falls under the description in paragraph (e) of the definition of an Investment Entity in the Bill. For example, a practical question arises where an FI may have an affiliated entity that satisfies the gross income test as described in paragraph (e)(ii) of the definition and the board of the affiliated entity consists of employees of the FI or the entity's investments are made by the employee of the FI, but there is no service agreement or authority granted to the FI to manage the activities of the entity. We request that clarification be provided on whether the employee's involvement in the business of the entity will render the entity as being

considered as "managed" by the FI and therefore resulting in the entity being regarded as an Investment Entity under paragraph (5) of the definition.

(p) **Collective investment scheme** – we note that the Bill includes a collective investment scheme authorised under the Securities and Futures Ordinance (Cap.571) in the definition of an Investment Entity. Members are concerned that this inclusion may potentially lead to a scenario where certain collective investment schemes "that are organised outside Hong Kong but are authorised in Hong Kong" to be considered as reporting FIs of both jurisdictions and consequently subject to the due diligence and reporting requirements of more than one CRS regime. It would be desirable if clarification could be given on how to determine the appropriate reporting jurisdiction, so as to avoid confusion and undue burden of multiple reporting by such collective investment schemes.

(q) **Passive income** – we note that the Bill incorporates the list of general passive income items under the OECD CRS Commentary. Also, we understand that the OECD CRS Commentary requires reference be made to each jurisdiction' s particular rules. Drawing from the industry's FATCA experience of practical complexity in applying the passive income definition, we would welcome further clarification and more elaborative explanation on the list of items, especially if any existing local regulations or guidance in Hong Kong may be referenced to in this respect.

(r) **Jurisdiction of residence** – we note that the jurisdiction of residence is defined in the Bill as a territory of which an individual or entity is a resident for tax purposes. Given the specification of this definition, we would suggest the Bill revise this expression as "jurisdiction of tax residence" where applicable for better clarity.

(s) **Treatment of specific types of accounts** – we would like to request guidance and clarification with respect to the treatment of the following specific types of account:

- Sole proprietorship – to confirm that this should be treated as an individual account;

- Account held by a non-reporting FI – to clarify whether this may be considered as an excluded account and to confirm that FIs are able to obtain self-certification from the account holders when in doubt;

- Client accounts held by non–FI intermediaries (e.g. a solicitor), which do not fall under the definition of escrow accounts under the Bill – under the existing AML/KYC procedures, referring to "Guideline on Anti-Money Laundering and Counter- Terrorist Financing (For Authorized Institutions) Revised March 2015" for solicitor's client accounts under section s.4(6), Sch. 2, 4.10.17, if a customer of an FI is a solicitor or a firm of solicitors, the FI is

not required to identify the beneficial owners of the client account opened by the solicitor, provided that the following criteria are satisfied: (a) the client account is kept in the name of the solicitor; (b) money or securities of the solicitor's clients in the client account are mingled; and (c) the client account is managed by the solicitor as those clients' agent. Challenges arise when the FI is not required to identify the beneficial owners of the client account under existing AML/KYC procedures but is required to perform due diligence and reporting as appropriate under the CRS. In view of this, we suggest further guidance be provided on the obligations of FIs towards these indirect clients. For instance, (1) the extent that FIs are required to approach the intermediary for the due diligence on indirect clients; and (2) the handling procedures should the indirect clients refuse to provide the necessary documentation. We suggest the Government to align with the AML requirements on the identification of the underlying account holders.

(t) **Participating jurisdiction** – it is noted that the Bill defines "participating jurisdiction" as a territory outside Hong Kong that is specified in Part 2 of Schedule 17E, which is intended to include a list of participating jurisdictions. We suggest that the list in Part 2 of Schedule 17E be kept updated and in consistency with any such information maintained by the OECD. It will be important for Reporting FIs to refer to this list in observing the AEOI standards; for example, to determine the status classification of a professionally managed investment entity, FIs may need to check whether the entity is located in a participating jurisdiction.

V. Compliance and enforcement

We note that the Bill introduces sanctions including fines and imprisonment on FIs, their employees and service providers for non-compliance with the AEOI requirements. We also note that the Bill proposes to penalise an account holder for knowingly or recklessly providing false self-certification, with the penalty proposed being in the form of a fine. We stress that the onus is on account holders to provide complete and accurate information in their self-certifications. As such, we welcome the Government's initiative to provide FIs with suitable "government-issued" language for insertion into self-certification forms, to remind account holders of their legal obligations with respect to false or incorrect self-certifications, as well as the associated penalty implications. We will count on the Government's assistance in this regard although member banks (FIs) would like the insertion of such language to be optional.

VI. Confidentiality of taxpayer's information

Various stakeholder groups have expressed concerns about data privacy and protection of additional customer information to be collected under the CRS. We understand that the Government will institute stringent controls and strict

operational security measures to protect the confidentiality of all data received, whether from FIs or from treaty partners. It would be helpful if more clarity on the intended implementation approach and plan of the Government in information security can be shared with FIs as early as practicable.