Bills Committee on Inland Revenue (Amendment) Bill 2016
Follow-up to the meeting on 11 April 2016

Purpose

This paper sets out the Government's responses to the concerns and views raised by Members at the meeting on 11 April 2016 regarding the provisions on the offences and search warrant in the Inland Revenue (Amendment) Bill 2016 ("the Bill").

Penalty Provisions

2. According to the Common Reporting Standard ("CRS") promulgated by the Organisation for Economic Cooperation and Development, a jurisdiction should have in place rules and procedures to ensure effective implementation of automatic exchange of financial account information in tax matters ("AEOI"). In order to provide for deterrent effect, we have proposed to put in place appropriate penalty provisions for non-compliance concerning reporting financial institutions ("FIs"), employees of relevant FIs, service providers and account holders.

(a) About self-certification

3. As we have clearly explained in the LC Paper No. CB(1)772/15-16(02) and at the meeting on 11 April 2016, even if an account holder, in making a self-certification, is suspected to provide misleading, false or incorrect information in a material particular, the Administration will not and cannot rely on the self-certification provided by the account holder to establish that the person concerned commits an offence. The Administration must conduct investigation in the first place so as to confirm if there is sufficient evidence to prove that the person concerned provides such information knowingly or in a reckless manner before taking prosecution actions.

4. When the Inland Revenue Department ("IRD") raises questions with the account holder during investigation, if IRD has reasonable cause to suspect that the account holder has committed an offence, IRD will caution the account holder and remind that account holder that he or she has the right to keep silent. The person concerned can choose to keep silent when he or she is asked for

explanation regarding the self-certification.

(b) About reporting FIs

5. The new section 80B(6)(a) in the Bill provides that if a reporting FI provides any information in the return that is misleading, false or inaccurate in a material particular, and –

(i) **knows** the information is misleading, false or inaccurate in a material particular;
(ii) is **reckless** as to whether the information is misleading, false or inaccurate in a material particular; or
(iii) has no reasonable ground to believe that the information is true or accurate,

it commits an offence.

6. When working on the formulation of "information that is misleading, false or inaccurate", we have made reference to relevant local and overseas (such as the UK and Singapore) legislation. An FI may have breached the law if, for instance, it provides **inaccurate** information on the total balance or value of a reportable account in its return; provides a **false** statement claiming that an account has no proceeds from the sale of financial assets in a specified information period despite the fact that there is such proceeds; or makes a **misleading** statement claiming that an account which may be a reportable account is an "undocumented account" (i.e. the FI has not followed the due diligence requirements to conduct further paper search or attempt to obtain documentary evidence, but reports that account as an undocumented account, and if the FI has followed all necessary due diligence requirements, the account should be regarded as a reportable one). However, whether the FI is held liable would depend on whether that FI is proved to provide such information **knowingly or in a reckless manner**.

(c) About service providers

7. According to CRS, a reporting FI may engage a service provider to carry out, for or on behalf of a reporting FI, all or part of the obligations concerning due diligence or reporting. CRS also stipulates that even if a

service provider is engaged, the reporting FI is not relieved from its due diligence and reporting obligations.

8. We have incorporated the above CRS arrangement into the new section 50H in the Bill. According to that provision, a reporting FI may engage a service provider to carry out specified services, including the services of **establishing or maintaining the due diligence procedures (section 50B), or furnishing returns to IRD (section 50C)**. Section 50H also stipulates that even if the service provider has been engaged in accordance with the specified scope under that provision, the relevant reporting FI is not relieved from its obligations required under the relevant provisions. In other words, **reporting FIs cannot shirk its responsibilities through engaging service providers.**

9. In fact, when handling their day-to-day operations, it is very common for FIs to engage service providers. Relevant regulatory authorities (such as the Hong Kong Monetary Authority, Office of the Commissioner of Insurance and Mandatory Provident Fund Schemes Authority) have provided guidelines regarding the engagement of service providers by FIs.

10. In terms of actual operation, the scope of services which can be provided by service providers to FIs may range from the development of operational manual, performance of customer due diligence measures, development of IT solution and generation of data files, to actual reporting of the relevant information to the tax authority. The actual scope of service covered by each service provider engaged by individual FIs may vary, depending very much on the latter's specific requirements. Reporting FIs may engage one or more service providers, but the services to be provided and responsibilities to be carried out by the latter (i.e. section 50B (about due diligence) and/or section 50C (about furnishing returns) will depend on the service agreements entered between the two parties. The relevant service providers may be solely or jointly liable, and much would depend on the actual circumstances and facts of specific cases. As the enforcement authority of the Inland Revenue Ordinance, IRD will, where possible, take appropriate actions and prosecute those who have breached the law, based on the actual circumstances involved. Enforcement actions against overseas service providers will be less straight-forward.

11. Since a service provider may be engaged by a reporting FI to take up

the obligations specified in the Bill (i.e. section 50B regarding the obligations to establish or maintain due diligence procedures and / or section 50C regarding the obligations to furnish returns), and these obligations are crucial for Hong Kong to deliver its obligations for AEOI, it is essential for us to put in place relevant offence provisions in respect of service providers, so as to avoid their non-compliance which would affect the implementation of AEOI arrangement.

12. Some Members raised concerns on whether the offences against service providers are too strict and unfair to service providers as they may be acting only in accordance with the instructions of FIs. We understand the concerns raised by Members. It is for this consideration that "without reasonable excuse" is included in section 80D, so that a service provider engaged to carry out a FI's obligations under section 50B or 50C would commit an offence even if it fails to establish or maintain due diligence procedures or furnish returns as required by the relevant provisions, **only if** it fails to do so **without reasonable excuse**. At the same time, in respect of the service provider's provision of any information in the returns that is misleading, false or inaccurate in a material particular, whether the service provider is liable for the offence concerned would be subject to whether the service provider is proved to have provided such information **knowingly or in a reckless manner**. So, we consider that the proposed offence provisions have struck a balance between facilitating the practical operation of FIs and ensuring effective implementation of AEOI arrangement.

Drafting issues

(a) Sections 80(2E), 80B and 80C

13. As set out in paragraph 6 above, for the offence provisions in sections 80B and 80C relating to the furnishing of information by reporting FIs, the wording of **"inaccurate"** is used, because the relevant provision involves the return provided by reporting FIs and such return contains figures such as computed account balance. As regards the proposed section 80(2E), since it involves personal data provided by account holders to reporting FIs (including name, address, jurisdiction of residence, and date of birth), the wording of **"incorrect"** is used instead. The relevant drafting is also in line with the wording of the existing section 80 (to which the proposed provision is to be added).

(b) Section 51B

14. Regarding the powers for the Commissioner of Inland Revenue or authorized officer to apply to a magistrate for warrants, the proposed section 51B(1AAAB) provides that the Commissioner or authorized officer is empowered to enter and have free access to a place where the Commissioner or authorized officer suspects there to be any articles or data of the reporting FI or its service provider (if any), or of any other person, that may afford evidence material in assessing **the liability of a person for tax of a reportable jurisdiction** (subsection (1AAAB)(a)(ii)).

15. Such liability has been covered by the matters which the magistrate has to be satisfied, i.e. that there are reasonable grounds for suspecting that a reporting FI or its service provider (if any) has failed to comply with section 50B(1) or (2) or 50C(1).

16. Section 50B(1) or (2) involves the due diligence obligations on a reporting FI or its service provider in establishing or maintaining procedures to identify whether a financial account is a reportable account, i.e. identify whether the account holder is a resident for tax purposes of a reportable jurisdiction, or **the liability of the person for tax of a reportable jurisdiction** as mentioned in subsection (1AAAB)(a)(ii).

Financial Services and the Treasury Bureau
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