Bills Committee on Inland Revenue (Amendment) Bill 2016
Follow-up to the meeting on 26 April 2016

Purpose

This paper sets out the Government's responses to the concerns and views raised by Members at the meeting on 26 April 2016 regarding the penalty provisions for account holders and service providers in the Inland Revenue (Amendment) Bill 2016 ("the Bill").

Penalty provisions for account holders providing self-certifications that are misleading, false or incorrect in a material particular

2. The arrangements which the Government explained over the meeting and undertook to follow, having regard to the concerns raised by Members, are summarized as follows –

(a) Self-certification is provided by an account holder as required by the reporting financial institution ("FI") in accordance with the due diligence requirements under the arrangement for automatic exchange of financial account information in tax matters ("AEOI"). Such certification is to enable the reporting FI to identify whether the relevant account is a reportable account, based on the tax resident status information provided by the account holder, in accordance with the Common Reporting Standard ("CRS") for different situations. When FIs seek self-certifications from account holders for this purpose, they would need to indicate the purpose and use of the self-certifications collected, as well as the possible legal liabilities on the part of the account holders.

(b) Even if an account holder, in making a self-certification, provides a statement which is 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**. According to the new section 80(2E) in the Bill, the account holder would commit an offence only if it has been proved that he **knows, or is reckless** as to whether, the statement is misleading, false or incorrect in a material particular. The need to prove *mens rea* of "knowingly" or "recklessly" sets a

considerably high threshold for prosecution. The Administration has to conduct investigation in the first place before being in a position to establish whether there are sufficient grounds to take prosecution actions.

(c) In actual operation, if the Inland Revenue Department ("IRD") considers that there is a need (such as receiving notification from the relevant AEOI partner that the information provided by Hong Kong to that reportable jurisdiction has missed certain reportable accounts), IRD will contact the relevant reporting FIs to ascertain if the FIs have carried out the due diligence procedures required to identify account holders who are residents for tax purposes of a reportable jurisdiction (including the procedures of collecting self-certification from the account holder and ascertaining the reasonableness of such self-certification). If IRD confirms that there is a need to follow up, **IRD will contact the relevant account holder and examine the information in the self-certification provided by that person**.

(d) During the process, the person concerned can provide further information and explanation to IRD to assist in the investigation. Even if the person concerned has admitted that there were errors in the information provided earlier, and then provided updated or other information in accordance with IRD's request, IRD still has to prove that the account holder provided the misleading, false or incorrect information **knowingly or in a reckless manner** in the first place before IRD can consider taking any prosecution action. When 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 him or her of 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.

3. Accordingly, having considered the concerns and views raised by Members and having reviewed section 80(2E), we consider that the existing proposed provision has already achieved the relevant effect, i.e. –

(a) **IRD cannot solely rely on the self-certification to establish that the person concerned has committed an offence**, unless the **two**

prescribed conditions (namely, (i) the account holder, in making the self-certification, makes a statement that is misleading, false or incorrect in a material particular; **and** (ii) knows, or is reckless as to whether, the statement is misleading, false or incorrect in a material particular) **are both met**; and

(b) the account holder has **the opportunity to defend his / her position when making explanation to IRD**, and has **the right to keep silent** as well.

4. Under the AEOI arrangement, the scope of information required to be provided by account holders to FIs and that required to be provided by FIs to IRD are limited and are drawn up in accordance with the specific requirements of CRS. Details are set out in **Annex A**. The penalty provision of section 80(2E) adopts the wording of "misleading", "false" and "incorrect", which generally follow the existing section 80 (about penalties for failure to make returns or making incorrect returns) of the Inland Revenue Ordinance ("IRO")[1]. Meanwhile, other overseas jurisdictions (such as Singapore) also adopt similar wording in their penalty provision regarding self-certification provided by account holders under the AEOI arrangement.

5. The successful prosecution cases made under section 80 of the IRO in recent years are set out in **Annex B.** These cases involve providing "false" or "incorrect" information. As for cases involving providing "misleading" information, there are no such cases under IRO in recent years. This in a way may reflect the greater difficulty in establishing the case for offence on such basis, when compared with the provision of "false" or "incorrect" information. Generally speaking, if certain important information in a material particular is missing in a statement, which make others wrongly believe that what is provided in the statement is the whole truth about the fact, this may constitute a misleading statement. However, to prove whether a person has breached the requirements in section 80(2E), IRD must establish that the person makes the misleading self-certification knowingly or in a reckless manner. As for other legislations such as the Securities and Futures Ordinance ("SFO"), there are successful prosecution cases concerning providing "false" or "misleading"

[1] Section 80(1AB) provides that a person who knowingly or recklessly makes a statement of the kind referred to in subsection (1AA)(a) which in a material respect is false or misleading commits an offence and is liable on conviction to a fine at level 3.

statement in a material particular. Relevant information is set out in **Annex B** for Members' reference.

6. In summary, we consider that the provision and the wording adopted in section 80(2E) are appropriate. When the Administration takes prosecution action, it will follow the arrangement as explained and undertaken by the Government when responding to Members' concerns and views.

Penalty provisions for service providers

7. Based on the relevant information gathered, overseas jurisdictions such as the UK and Ireland also made provisions, when formulating their relevant legislation on AEOI, to permit reporting FI to engage a service provider to carry out, for or on behalf of a reporting FI, all or part of the latter's due diligence and / or reporting obligations. They also stipulate that even if a service provider is engaged, the reporting FI is not relieved from its obligations concerned. The above reflects the arrangement specified in CRS.

8. As regards penalties, the relevant legislations of the overseas jurisdictions stipulate that any person is liable if the person fails to comply with any obligations under the relevant legislation. Hence, even though they have not provided for any penalties specifically for service providers, the general penalty provisions will still be applicable to service providers. Having regard to the feedback collected in the consultation that stakeholders would like the Government to ensure clarity as far as practicable when formulating penalty provisions, we have provided **clear penalty provisions** regarding all relevant parties (i.e. reporting FIs, FIs' employees and service providers).

9. As the Bill permits the reporting FIs to engage service providers to carry out, for or on behalf of reporting FIs, all or part of the obligations concerning due diligence/furnishing returns, and on the premise that the relevant FIs are not relieved from their obligations, it is fair and necessary to provide for penalty provisions on service providers which fail to comply with the obligations. Furthermore, the work to be carried out by service providers on behalf of the reporting is crucial for Hong Kong to fulfill its obligations for AEOI. **Putting in place relevant offence provisions in respect of service providers can ensure that the service providers would carry out their obligations, so as to avoid any non-compliance on their part which would**

affect the effective implementation of AEOI arrangement. This is different from the current situation concerning the reporting of tax liabilities by taxpayers or their agents to IRD under IRO. While a taxpayer may engage an agent as his or her tax consultant under IRO, the agent **cannot** sign on the tax return on behalf of the taxpayer or furnish the tax return on behalf of the taxpayer to IRD.

10. Furthermore, the proposed penalty level on service providers is drawn up after thorough consideration. In general, if a service provider fails to comply with its relevant obligations without reasonable excuse, or provides information that is misleading, false or inaccurate in a material particular in a return knowingly or in a reckless manner, the penalty is a fine at level 3 (i.e. $10,000). The service provider providing misleading, false or inaccurate information in a material particular in a return may be subject to imprisonment only if it does so with intent to defraud. The above proposed arrangement is in line with the penalty level provided under the existing IRO.

11. To conclude, we consider that it is necessary to provide for the proposed penalties on service providers, and that we have struck a balance between facilitating the practical operation of FIs and ensuring effective implementation of AEOI arrangement.

Financial Services and the Treasury Bureau
May 2016

Annex A

Information required to be provided by account holders and reporting FIs under AEOI arrangement

Account holders

In accordance with CRS, information must be provided by account holders in a self-certification includes –

Individual accounts
(a) name;
(b) residence address;
(c) jurisdiction(s) of residence for tax purposes;
(d) TIN; and
(e) date of birth.

Entity accounts
(a) entity's name;
(b) address;
(c) jurisdiction(s) of residence for tax purposes;
(d) TIN;
(e) if controlling persons are reportable persons, their –
    (i) name;
    (ii) residence address;
    (iii) jurisdiction(s) of residence for tax purposes;
    (iv) TIN; and
    (v) date of birth.

2. We will provide guidelines for the trade's reference regarding the above information to be included in self-certification. We will not restrict the FIs' design on the format of the self-certification.

Reporting FIs

3. Section 50F in the Bill has clearly set out the information required to be furnished by the reporting FIs to IRD, which are summarized as follows –

(a) name and identifying number of the FI;

(b) in relation to each reportable account –

(i) if the account holder is an individual who is a reportable person – the name, address, jurisdiction of residence, TIN, and the date and place of birth of the individual;

(ii) if the account holder is an entity that is a reportable person – the name, address, jurisdiction of residence and TIN of the entity;

(iii) if the account holder is an entity and at least one controlling person of the entity is a reportable person – the name, address, jurisdiction of residence and TIN of the entity; and the name, address, jurisdiction of residence, TIN, and date and place of birth, of each reportable person;

(iv) the account number (or functional equivalent in the absence of an account number); and

(v) the account balance or value (including, for a cash value insurance contract or an annuity contract, the cash value or surrender value), or (if the account was closed during such period) the closure of the account; and

(c) in case of any custodial account –

(i) the total gross amount of interest, the total gross amount of dividends, and the total gross amount of other income generated with respect to the assets held in the account paid or credited to the account (or in respect of the account);

(ii) the total gross proceeds from the sale or redemption of the financial assets paid or credited to the account; or

(d) in the case of any depository account, the total gross amount of interest paid or credited to the account; or

(e) in the case of any account not described in (c) and (d): the total gross amount paid or credited to the account holder with respect to which the reporting FI is the obligor or debtor, including the aggregate amount of any redemption payments made to the account holder.

Annex B

Successful prosecution cases for providing incorrect, false or misleading statements under relevant local legislation

Successful cases for providing incorrect or false statements under IRO

Providing incorrect statements

Case 1: The defendant was charged with filing incorrect tax returns for the years of assessment 2003-04 and 2004-05 by making incorrect statements in connection with the claim for dependent parent allowance. This was contrary to section 80(2)(b) of the IRO. The defendant declared that in each of the two years of assessment, she had contributed $12,000 or more towards the maintenance of a dependant. IRD later found that the dependant had passed away on 15 March 15 2002. The defendant was fined $54,650 on 30 July 2008 after pleading guilty to charges of making incorrect tax returns.

Case 2: The defendant was charged with filing an incorrect tax return for the year of assessment 2005-06 by making an incorrect statement in connection with the claim for elderly residential care expenses, contrary to section 80(2)(b) of the IRO. The defendant declared that in the year of assessment 2005-06, she had paid residential care expenses of $42,000 to a residential care home for maintaining a dependant. Investigations by IRD found that the dependant passed away on 17 December 2003. The defendant was fined a total of $10,000 after pleading guilty on 18 January 2008 to a charge of making an incorrect tax return.

Providing false statements

Case 1: The defendant is a regional sales director for a property agency company in Hong Kong. He was charged with four counts of evading tax, wilfully with intent, by making false statements in connection with claims for deduction of expenses for self-education and approved charitable donations in his tax returns for the years of assessment 2007-08 to 2010-11, contrary to section 82(1)(c) of the IRO. The defendant was convicted on 22 January 2016 of wilfully making false statements in four tax returns with intent to evade salaries tax. He was sentenced on 5 February 2016 to 200 hours'

community service and fined a total of $278,800, equivalent to 200 per cent of the tax evaded.

Case 2: The defendant is a former senior manager of an accounting firm. She made false statements or entries in her tax returns for the years of assessment 2004-05 to 2008-09, seeking to reduce her assessable income by falsely claiming rental reimbursement, contrary to section 82(1)(b) of the IRO. The defendant was convicted on 18 June 2014, and was sentenced on 14 July 2014 to 160 hours' community service and fined $20,000 for each charge, making a total fine of $100,000, equivalent to about 86 per cent of the tax evaded.

Successful cases for providing false or misleading statement in a material particular under SFO

Case 1: The defendant company is a Hong Kong-listed company. The defendant company and its director are each charged with three counts under section 384 of SFO, which makes it an offence for a person to provide false or misleading information to the Stock Exchange of Hong Kong ("SEHK"). Between 11 February 2008 and 28 February 2008, the closing price of shares in the defendant company rose by approximately 136% with increased turnover. Following queries made by the SEHK, the defendant company made three announcements on 15 February 2008, 18 February 2008 and 20 February 2008 respectively. In each announcement, the defendant company said that it knew of no negotiations or agreements which were disclosable to the market nor were its directors aware of any price sensitive matter. The Securities and Futures Commission ("SFC") alleged that these announcements were false and misleading because the defendant company was simultaneously taking steps to acquire control of a private entity which held approximately 50% of another Hong Kong-listed company, with a market value of about $145 million. SFC alleged this was a material acquisition for the defendant company and ought to have been disclosed in response to the inquiries made by the SEHK in light of the substantial movement in the share price of the defendant company. The defendant company was convicted. It was fined $60,000 on 5 August 2013, and ordered to pay investigation costs to SFC.

Case 2: The defendant made false or misleading representation to SFC in two

licence applications, contrary to section 383 of the SFO. That provision stipulates that it is a criminal offence if a person, in an application to SFC made under or pursuant to the SFO, knowingly or recklessly makes a materially false or misleading representation. In July and December 2011 respectively, the defendant in two SFC licence applications claimed that his company had liquid capital and paid-up share capital that satisfied the minimum requirements under the Securities and Futures (Financial Resources) Rules ("FRR") when in fact the amounts were substantially below the minimum requirements. In respect of each licence application, the defendant caused money to be transferred temporarily into the bank account of Hong Kong Securities to meet the FRR requirements, and then transferred the money out shortly afterwards. The defendant was convicted. He was fined $40,000 and ordered to pay the SFC's investigation costs.