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By email (smwlo@legco.gov.hk)

18 December 2017

Clerk to Bills Committee
(Attn: Miss Sharon Lo)
Legislative Council Secretariat
Legislative Council Complex
1 Legislative Council Road
Central, Hong Kong

Dear Miss Lo,

Inland Revenue (Amendment) (No. 5) Bill 2017

Thank you for your email dated 30 November 2017 relaying Hong Kong Association of Bank's written submission on the captioned Bill. Our response is set out in the attached note.

Yours sincerely,

(Ms Pecvin Yong)
for Secretary for Financial Services and the Treasury

c.c.
Commissioner of Inland Revenue (Attn: Mr KK Chiu)
Department of Justice (Attn: Ms Phyllis Poon)

Inland Revenue (Amendment) (No. 5) Bill 2017

Government's Response to the Written Submission from Hong Kong Association of Banks ("HKAB")

We are pleased to note that the HKAB supports Hong Kong's participation in multilateral tax agreements and recognises the need of aligning Hong Kong's legislative framework for automatic exchange of financial account information in tax matters ("AEOI") with the Common Reporting Standard ("CRS") as promulgated by the Organisation for Economic Co-operation and Development ("OECD"). The Administration's responses towards the views and issues raised by the HKAB are set out below.

CRS-aligned provisions and support to FIs

2. While the amendments concerning AEOI under the Bill aim to align some current provisions under the Inland Revenue Ordinance (Cap. 112) ("IRO") with the CRS without substantial changes to the due diligence requirements, we understand that reporting financial institutions ("FIs") would take time to fine-tune their systems and mode of operation in order to implement the refinements. As the Bill will not be enacted before 31 December 2017, the refinements as proposed in the Bill will not apply to the first report by reporting FIs due for May 2018 (covering data in 2017).

3. As for the second report of data in 2019 (covering data in 2018) and thereafter, the arrangements provided under the Bill at present are as follows on the assumption that the Bill will be enacted within 2018 –

(a) From 1 January 2018 to the date that the Bill is enacted, the current statutory provisions governing the identification of reportable accounts under the IRO ("Existing Provisions") will continue to apply. The new provisions to be aligned with the CRS contemplated under the Bill ("Refined Provisions") will not kick in.

(b) From the date that the Bill is enacted till 31 December 2018, the Refined Provisions will apply.

(c) The Refined Provisions will also apply to the third report due for May 2020 (covering data in 2019) and thereafter.

4. We understand that the proposed arrangements for the second reporting due for May 2019 may bring operational inconvenience to reporting FIs. Taking into account the concerns expressed by the HKAB and in order to minimise the compliance burden on FIs, we would like to propose that **the Existing Provisions will also apply to the second report due for May 2019 (covering data in 2018).** In other words, **the Refined Provisions will only start to apply on 1 January 2019 for the purpose of the third report due for May 2020 (covering data in 2019).** We will propose this change by way of Committee Stage Amendments to the Bill.

Technical changes in the AEOI legislative framework

Definition of "controlling person"

5. According to the CRS, the term "controlling persons" means the natural persons who exercise control over an entity, and must be interpreted in a manner consistent with the Financial Action Task Force ("FATF") recommendations[1]. Further, the CRS provides that for the purposes of determining the controlling persons of an account holder, a reporting FI may rely on information collected and maintained pursuant to Anti-Money Laundering/Know Your Customer ("AML/KYC") procedures[2]. "AML/KYC procedures" is defined in section 50A(1) of the IRO and refer to the customer due diligence procedures required to be carried out by a reporting FI pursuant to anti-money laundering requirements or similar requirements (including requirements to know a customer) to which the reporting FI is subject to.

6. Under the Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615) ("AMLO") which has incorporated FATF's recommendations in Hong Kong, FIs are required to conduct statutory due diligence measures so as to identify and verify the customers' identity and their beneficial owner(s). As explained to the

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1 Subparagraph D(6), Section VIII of the CRS (p. 57).

2 Subparagraph D(2)(b) and (c), Section V (p.39 and 40); and subparagraph A(2)(b), Section VI (p. 42) of the CRS. This has also been reflected in the IRO – see sections 8 and 9, Division 3, Part 5, Schedule 17D; and section 5, Part 6, Schedule 17D.

Legislative Council during the scrutiny of the Inland Revenue (Amendment) Bill 2016, in order to reduce the compliance burden of FIs in carrying out the due diligence procedures for AEOI, it is the Government's policy that FIs may resort to information collected under the AMLO in performing the relevant due diligence requirements (including the AML/KYC procedures) under the AEOI regime. This is also provided for under the CRS.

7. Given the AMLO has already incorporated FATF's recommendations in Hong Kong, we consider it appropriate to draw reference to the AMLO as far as practicable (in particular the interpretation of "beneficial owner") in formulating the legislation for "controlling person" under the IRO for the AEOI regime.

8. On the proposed amendment to the specified percentage for determination of controlling person under section 50A(6) of the IRO from "not less than 25%" to "more than 25%", we agree that the scope of controlling person will be narrowed. We would also like to confirm that FIs will need to redetermine if those who are already classified as controlling persons under the Existing Provisions would still be considered as such under the Refined Provisions.

9. The term "enforcer of the trust", which appears under the interpretation of "beneficial owner" in relation to a trust in AMLO, is not defined in FATF's recommendations, CRS, AMLO or IRO. Therefore the term should here be given its ordinary or literal meaning in the context of the proposed provision and the IRO. In *Shorter Oxford English Dictionary*, "enforcer" means a "person, organisation, etc. that enforces something" and "enforce" means "compel the occurrence or performance of" and "compel the observance of (a law, rule, practice, etc.)". Accordingly, an "enforcer of the trust" could be a person that compels the occurrence, performance or observance of the trust. The Inland Revenue Department ("IRD") will provide guidance in its guidelines upon passage of the Bill.

10. As for the proposed repealing of section 50A(6)(c)(iv) which states "exercises ultimate control over the management of the entity; or" and substituting with "has ultimate control over the entity; or" in the case of a trust, the IRD is also prepared to elaborate in the relevant guidelines upon

passage of the Bill. We do not propose inserting the word "effective" between "ultimate" and "control" because the term "ultimate control" is derived from the definition of "beneficial owner" in the AMLO. Following our policy that FIs may rely on the due diligence requirements under the AML/KYC procedures as far as practicable, we consider it appropriate to draw reference to the AMLO in formulating the definition of "controlling person" under the IRO for the AEOI regime.

Record keeping requirements

11. Under the CRS, **both** evidence relied on, and any record of the steps taken in carrying out the due diligence procedures are required, but not either one[3]. We appreciate the associated compliance efforts required and believe that our latest proposal in paragraph 4 above would address the concern.

Definition of "exempt collective investment vehicle"

12. Clause 9 of the Bill improves the clarity in relation to collective investment vehicles that could be exempt from reporting. There is no change in the intended scope of exemption. The IRD will revise its guidelines upon passage of the Bill.

Definition of "dormant account"

13. We took the opportunity to clarify the necessary criteria that have to be fulfilled before an account is treated as dormant under clause 10 of the Bill to reflect the CRS requirements. The prevailing guidelines published by the IRD set out its interpretation of "dormant account" that reflects the above necessary criteria. It is necessary to update the IRO in this regard so as to provide a legal definition of "dormant account" under the IRO.

14. The proposed addition of section 7(2) in Schedule 17C, Part 3 of the IRO (i.e. clause 10(4) of the Bill) aims to provide for an alternative situation which FIs may rely on in treating an account as "dormant". The provision under the newly added section 7(2) in Schedule 17C, Part 3 of the

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[3] Subparagraph A(2), Section IX of the CRS (p. 61).

IRO aims to clarify the current arrangement under section 7(c) and is in line with the CRS requirements[4]. Again, the IRD will elaborate on the term "substantially similar" in its guidelines upon passage of the Bill.

Determining residence of controlling persons of passive NFE

15. Currently, it is stipulated under Schedule 17D, Part 4, sections 2(1)(b) and 2(3) of the IRO that a reporting FI must confirm the reasonableness of the self-certification on the opening of a new individual account and that the reporting FI must obtain another valid self-certification in prescribed circumstances.

16. It is the CRS requirement that a reporting FI may **only** rely on a self-certification (with no other reliance) from either an account holder or controlling person for the purpose of determining the residence of a controlling person of a passive NFE for new entity accounts[5]. The CRS further stipulates that "given that obtaining a self-certification for new accounts is a critical aspect of ensuring that the CRS is effective, it is expected that jurisdictions have strong measures in place to ensure that valid self-certifications are always obtained for new accounts"[6].

17. In ensuring effective implementation of AEOI in Hong Kong as required by the OECD, we need to amend the IRO to clarify the above. Under the Refined Provisions, FIs can no longer determine the residence of those controlling persons of passive NFEs (as account holders of New Entity Accounts) if the controlling persons or the account holders do not provide self-certification. Again, the IRD will provide further guidance in its guidelines upon passage of the Bill.

Financial Services and the Treasury Bureau
December 2017

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[4] Paragraph 9, Commentary on section III of the CRS (p. 112).
[5] Paragraph 20, Commentary on section VI of the CRS (p. 148).
[6] Paragraph 18, Commentary on section IX of the CRS (p. 211).