THE HONG KONG ASSOCIATION OF BANKS
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By email: bc_01_17@legco.gov.hk

Bills Committee on Inland Revenue (Amendment) (No. 5) Bill 2017
Legislative Council Complex
1 Legislative Council Road
Central, Hong Kong

Dear Sirs

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

The Hong Kong Association of Banks ("HKAB" or "we") refer to the Inland Revenue (Amendment) (No. 5) Bill 2017 ("Amendment Bill") and write to submit our comments.

We note that the Amendment Bill seeks to cover two main areas – one, to empower the Chief Executive to give effect to the Multilateral Convention on Mutual Administrative Assistance in Tax Matters and other tax agreements that apply to Hong Kong and two, to amend certain Inland Revenue Ordinance ("IRO") provisions on the automatic exchange of financial account information ("AEOI").

We support the Government's effort to facilitate Hong Kong's participation in multilateral tax agreements in order to further enhance international tax cooperation. At the same time, while we appreciate the need for alignment with the OECD standard on AEOI, we would like to take the opportunity to submit our views on some of the amendments to the IRO provisions which we believe would have an operational impact in the context of the manner in which many of our members are presently implementing their AEOI policies and procedures.

We wish to draw the Government's attention to the fact that by now financial institutions ("FIs") would have carried out new account onboarding procedures for 10 months and nearly completed due diligence procedures on high value pre-existing individual accounts, in readiness for the completion due date of 31 December 2017. It is therefore important that the legislative effect of the amendments only commences from 1 January 2018 (and not before) so that FIs would not be required to revisit aspects of their procedures that are likely to be impacted, such as where controlling persons and dormant accounts have already been identified pursuant to conditions provided for in the current legislation.

We set out our other views and the clarifications that we would like to seek below for the Government's consideration:

1. Section 50A(1) - Amendment of paragraph (a)(ii) of the definition of cash value

   The insertion of ", or with regard to," into paragraph (a)(ii) would have the effect of extending the scope of cash value to encompass not only the amount a policyholder can borrow under an insurance or annuity contract but also in association with such a contract. Banks would likely have to expand their present scope of review to include contracts in association with an account. Therefore, impact assessment and remediation are likely to be required.

2. Amendment of definition of controlling person in Section 50A(6)

   Section 50A(6)(a)(i)(A) and (B), Section 50A(6)(b)(i)(A) and (B), Section 50A(6)(c)(i):

   With the amendment of the specified percentage for the determination of controlling person from "not less than 25%" to "more than 25%", the scope of controlling person will be narrowed, i.e. current controlling persons having 25% of issued share capital of the entity will be out of scope after the amendment. As such, banks' current operating model will be affected; for instance, customer communication materials, policies and procedures, systems, data management, training will all have to be revised. Consequential impacts on due diligence and reporting also require attention to suit the change.

   We would also be grateful if clarifications are given as to whether banks will need to reconsider if those who are already classified as controlling persons under the current legislation would still be considered as such under the proposed amendment. Banks would need specific guidance as to whether banks should discard data of those who no longer meet the new definition of controlling person, or would be empowered to report those out-of-scope data amid the possibility of over-reporting which may raise concerns over Data Protection Principle(s) under the Personal Data (Privacy) Ordinance.

   Section 50A(6)(c)(iii):

   We would like to understand the reason for including an enforcer of a trust as a controlling person of the trust (we note that this is not in line with the OECD standard). It would be helpful if the IRD can provide a definition of 'an enforcer of a trust' either in the IRO or in the IRD guidance.

Section 50A(6)(c)(iv):

While repealing subparagraph (iv) which states "exercises ultimate control over the management of the entity" and substituting it with "has ultimate control over the entity" in the case of a trust, it would be helpful if an example can be provided in the Inland Revenue Department's Guidance for Financial Institutions ("IRD guidance") to illustrate how an individual is considered to exercise ultimate control over the trust in this context in order to help implementation. We would also like to confirm that the amendment has the effect of narrowing the scope of controlling person and should therefore result in fewer in-scope customers. If so, this would similarly require banks to re-examine the profile of current controlling persons and thus have the same operational impact as the amendment of the specified percentage.

In addition, we would like to clarify whether, under the proposed definition, a person who based on the terms of the trust does not technically have ultimate control could never be a controlling person, and if the test for control is based on whether it has been conferred on the person by the terms of the trust i.e. "has" or whether the person (even if not ostensibly conferred such power) does in fact exercise ultimate control.

Finally, if we aim for maximal alignment with the OECD standard, it would appear appropriate to insert the word "effective" in between "ultimate" and "control".

3. Section 50B(1)(a)(iii) – Amendment to record of steps taken as part of due diligence obligations on reporting financial institutions

Substituting "or a record" with "**and** [emphasis added] any record" of the steps taken for carrying out the due diligence procedures in relation to a financial account requires banks to collect and secure more evidence, i.e. evidence relied on and record of the steps taken (instead of either one of the two as provided for in the current legislation). This would increase the compliance burden on banks around evidence collection since the obligation for due diligence would include not only the outcome but also any step taken towards the outcome when performing these obligations under the proposed amendment. With this substitution, we wish to draw your attention to the fact that evidence (of steps taken) may stem from systems (automated) and/or manual workflow steps. As a result, it would pose significant difficulty for banks to find ways to comprehensively retain evidence under the circumstance. In this connection, we would like to seek for clearer guidance around cases onboarded since 1 January 2017.

4. Schedule 17C Part 2 Section 9(1)(b) –Amendment to the definition of exempt collective investment vehicles

We understand the amended wording would better align with the OECD standard but would like to confirm that the amendment will not change the scope for exempt collective investment vehicles.

We also request that the IRD guidance be updated once the Amendment Bill receives passage at LegCo.

5. Schedule 17C Part 3 Section 7 – Amendment to definition of dormant account

Section 7(1)(a), Section 7(1)(b):

Under the proposal, an account which is not a cash value insurance contract ("CVIC") would need to satisfy both of the following (vs either of the two currently) to qualify as a dormant account:

(a) the account holder has not initiated a transaction with regard to the account or any other account held by the account holder with a reporting financial institution in the previous 3 years
(b) the account holder has not communicated with the reporting financial institution regarding the account or any other account held by the account holder with the reporting financial institution in the previous 6 years

This amendment appears to cause the definition of dormant account in the case of a non-CVIC to be tightened, thus some accounts will no longer be dormant under the new definition and will become in scope for CRS purposes. We understand that such amendment attempts to follow the OECD standard and IRD guidance. We would like to confirm that the present IRD guidance contains the correct interpretation.

In any case, banks would need to revisit customer dormant accounts with a view to identifying those that would not meet the amended definition of dormant account. The additional compliance burden is likely to be compounded by the fact that FIs would be required to remediate such additional accounts.

Section 7(2):

This amendment provides an additional set of parameters for an account to be qualified as a dormant account, requiring that the normal operating procedures that the FI applies to the determination of a dormant account be substantially similar to subsection (1)(a), (b) (and (d)). This would significantly add to the scope of review

of accounts and again entail FIs revisiting customer accounts to re-determine their dormant status. In order for our members to ascertain how the proposed requirements are to be operationalized, we request that the term "substantially similar" to be defined in the IRD guidance for clear reference for FIs.

6. Schedule 17D Part 6 Section 6 – Amendment to determination of residence of controlling person of passive NFE during new account due diligence procedures

   It is proposed that a FI may rely **only** on a self-certification from the (entity) account holder or the controlling person in order to determine the controlling person's residence. Currently if a FI is not able to obtain a self-certification from the controlling person (self-certification form - controlling person) on account opening or within 90 days, and if the controlling person is also an account holder, the FI may rely on the self-certification (self-certification form - individual) obtained from due diligence procedures for individual accounts to determine the residence of the controlling person. If a self-certification is still not obtained in this manner, the FI may consider closing the account.

   Requiring FIs to only rely on a self-certification from the entity account holder or the controlling person would likely lead to more instances of an FI needing to consider closing an entity account if it is not able to obtain a self-certification form - controlling person since FIs are no longer allowed to determine the controlling person's residence through other means currently afforded to FIs elsewhere in the IRO. We would like to understand if the intended legislative change would mean that FIs can no longer derive jurisdiction(s) of tax residency for these controlling persons of new accounts. Further, we would like to seek clarification on remedial measures FIs could put in place to handle controlling persons who do not provide any self-certification. Without this clarification FIs will be unable to open new accounts under the proposal which may cause customer expectation management issues.

We would be pleased to support the Bills Committee in its consideration of the Bill. Should you have any questions, please do not hesitate to contact HKAB Secretariat (Ivy Wong at 2526-8895).

Yours faithfully

Celia Shing
Secretary