Consultation on Automatic Exchange of Financial Account Information in Tax Matters ("AEOI")

Consolidated Response of the Government

Introduction

The Government launched a consultation exercise in April to June 2015 to gauge views on how we should adapt to Hong Kong the new standard on AEOI promulgated by the Organisation for Economic Cooperation and Development ("OECD")[1]. Having carefully considered the views expressed, we have formulated a consolidated response, based on which we will refine the legislative proposals for the implementation of AEOI in Hong Kong.

An Overview

2. In general, stakeholders support the overall direction to catch up with the latest international standard and implement AEOI in Hong Kong. They recognize that it is essential for Hong Kong to maintain our position as an international financial centre and to ensure that we would not be labelled as a non-cooperative tax jurisdiction in the international community.

3. In response to the seven key questions flagged up in our consultation paper, the major views received and our general position are summarised as follows –

(a) **Financial institutions (FIs), non-reporting FIs and excluded accounts** – 29 parties have commented on the proposed definitions of FIs or **requested exemptions** as non-reporting FIs and/or excluded accounts. In considering possible exemptions for FIs or financial accounts, we would follow the overriding criteria as set out in the Common Reporting Standard ("CRS") promulgated by OECD that any FIs or financial accounts to be exempted from reporting should be those which bear low risks of being used for tax evasion, have substantially similar characteristics to certain exemption categories specified in the CRS, subject to regulation, and that the exemption would not frustrate the objective of CRS. In the light of

[1] Three consultation sessions were arranged for relevant stakeholders and over 12 meetings/seminars organized by various financial institution ("FI") groups were attended by FSTB and IRD. A total of 43 written submissions have been received.

feedback, we will state explicitly in the proposed legislation that Mandatory Provident Fund schemes, Occupational Retirement Schemes and credit unions registered under the relevant statutes will be "non reporting FIs" and that dormant accounts will be excluded.

(b) **Reporting requirements** – 24 submissions have covered this aspect. In gist, their views were that information to be reported should be kept to the **minimum necessary** in accordance with the CRS requirements with **flexibility** allowed if possible and that the legislation should **clearly define** which should be the reporting FIs and their responsibilities. We are **in agreement** with the advice.

(c) **Due diligence procedures** – 26 submissions have flagged up these issues, mainly on how to ascertain tax residence and administer the self-certification arrangement, how to ride on the due diligence procedures for anti-money laundering ("AML") for AEOI purpose, whether or not *de minimis* rules can be provided to reduce compliance costs, and whether alternative options for reporting as provided for under CRS would be allowed in Hong Kong. We acknowledge stakeholders' concerns and would be **prepared to incorporate** in the legislation alternative options under CRS and to allow FIs to leverage on the due diligence procedures under AML such as those in ascertaining the permanent residence address, so long as such arrangements are permitted under CRS.

(d) **Requirements for FIs to identify and keep information of accounts concerning reportable jurisdictions** – Amongst the 22 submissions which covered this aspect, the majority consider that a **wider approach should be allowed** to reduce FIs' compliance costs, i.e. the proposed legislation should provide for the legal basis for FIs to collect information of all non-Hong Kong tax resident account holders if they wish and so long as they can comply with the requirements of the Personal Data (Privacy) Ordinance ("PDPO") (Cap. 486). A few others however considered that a targeted approach may better cater for the circumstances of the small-to-medium sized FIs and hence causing less burden on them. In line with the feedback received, we **will** impose requirements on FIs based on a "targeted approach" and **allow FIs the option of adopting a wider approach** under specified conditions.

(e) **Proposed sanctions** – 26 submissions have flagged up concerns in this regard, mainly questioning the need for sanctioning employees of an FI. While not disputing the need to sanction FIs, they consider that the level of penalties on FIs **should not be too heavy** and that sanctions should also be imposed on account holders for providing false self-certification. In formulating the proposed sanctions, we need to provide for sufficient deterrent effect to ensure effective implementation of AEOI in Hong Kong on the one hand, while not imposing disproportionately high level of sanctions on FIs and individuals on the other. In the light of feedback, we will **drop** one of the proposed offences for employees of FIs - causing or permitting, without reasonable excuse, the FIs to provide incorrect return. Where the non-compliance was wilful, however, the employees of FIs will still be held liable.

(f) **Confidentiality and notification** – 24 submissions have expressed views on this aspect. Most do not object to the Government's proposal for FIs to notify account holders for the purpose of AEOI in a generic manner. Some suggest legislating for such a requirement and providing avenue for account holders to appeal, similar to that under the current Exchange of Information (EOI) on request mechanism. Some have expressed concerns on whether AEOI meets the standard of "foreseeable relevance" and whether the proposal would comply with the right to privacy. The Government attaches great importance to protecting the data privacy of taxpayers and the confidentiality of information to be exchanged. All existing confidentiality safeguards for EOI under international standard will continue to apply to AEOI. Notification for account holders is not a requirement under CRS for AEOI implementation. However, in order to comply with PDPO requirements, we will **remind FIs** that they should inform the account holders of the possible use of the information collected for AEOI purpose.

(g) **IT system** –15 submissions have covered this aspect. Smaller-sized FIs prefer to use the software to be developed by the Inland Revenue Department ("IRD"); bigger ones state that they can develop their own software for AEOI purpose but need more detailed specifications from IRD. The Government will continue to **engage stakeholders** in developing the IT system so as to ensure smooth implementation of AEOI.

Detailed Response

Guiding Principles

4. In formulating the legislative proposals to implement AEOI in Hong Kong, the Government is **obliged to follow the OECD standards**, including the generic definitions of FIs, the scope of coverage of reporting FIs and reportable accounts, and the due diligence requirements, which form the **building blocks** for our legislative framework. To provide certainty and avoid ambiguity leading to non-compliance, we will make suitable **adaptations** of the generic terms and general requirements for enforcement in Hong Kong, with references to Hong Kong laws where appropriate. In any event, the Government will adopt a **pragmatic approach** to prescribe the requirements and sanctions on FIs, FIs' employees or account holders for **effective implementation**.

Definitions of FIs

5. A few stakeholders questioned the need to expressly include in the generic definition of FIs local references as follows –

(a) **"Corporation licensed under the Securities and Futures Ordinance ("SFO") (Cap. 571)"** – our view is that such reference is necessary to provide clarity and certainty in the application of the CRS definition in the local context. For CRS purpose, an entity can be either categorized as an FI (which bears the reporting obligations, but is exempt from reporting by other FIs) or non-financial entity (which is being reported by FIs). The inclusion of "licensed corporation" under the definition of "investment entity" would avoid any uncertainty over who needs to report or who gets reported. It should be noted that only the licensed corporation maintaining financial accounts will be responsible for the due diligence and reporting obligations with respect to such financial accounts. This is similar to the rationale for including the reference to "an authorized institution as defined under section 2(1) of the Banking Ordinance (Cap. 155)" under the definition of "depository institution" and "an insurer authorized under the Insurance Companies Ordinance (Cap. 41)" under the definition of "specified insurance company" respectively; and

(b) **"Trust company registered under the Trustee Ordinance" (under the definitions of "custodial institution" and "investment entity")** – after careful consideration with relevant authorities, we propose to delete it from both definitions on the ground that such reference may inadvertently expand the scope of coverage of the CRS definition, covering various types of trusts to which the Trustee Ordinance (Cap. 29) applies **but fall outside of the scope of "investment entities" under the CRS**. These include trust companies managing trusts holding non-financial assets, private trusts holding non-financial assets (e.g. landed properties) etc. Notwithstanding the proposed changes, any entity (including a trust) will still be covered under the CRS definition of "investment entity" in the proposed legislation, so long as it primarily conducts as a business the specified investment activities for or on behalf of customer or its gross income is primarily attributable to investing, reinvesting, or trading in financial assets, and if it is managed by another entity that is a depository institution, a custodial institution, a specified insurance company or an investment entity. Likewise, any entity (including a trust company) is covered under the CRS definition of "custodial institution" in the proposed legislation, if it holds, as a substantial portion of its business, financial assets for the accounts of others.

6. We have also taken the opportunity to revisit the need to include a specific reference to "collective investment scheme (CIS) or structured product authorised under the SFO" in the definition of "investment entity". To provide clarity, we see the need to retain the reference to **"CIS"** which clearly falls within the scope of investment entities and then provide for express exemption for those exempted CISs which we do not intend to catch, such as some forms of mandatory provident fund schemes. As for **"structured product"**, we propose to remove such reference from the definition in the proposed legislation to avoid any over-catching. Any specific product will be covered under the "catch-all" definition of "investment entity", so long as it primarily conducts as a business the specified investment activities for or on behalf of customer or the gross income of which is primarily attributable to investing, reinvesting, or trading in financial assets and it is professionally managed,

7. Some stakeholders asked whether Real Estate Investment Trusts ("REITs") and Exchange Traded Funds ("ETFs") will be caught by the CRS as "investment entities", and if yes, whether they would be expressly provided in the AEOI legislation. **REITs** and **ETFs** will be covered by the definition of "investment entity" so long as they meet the generic definition of "investment entity".

8. Taking into account the changes as mentioned in paragraphs 5 and 6 above, the latest revised definitions for FIs are set out in Annex A.

Scope of non-reporting FIs and excluded accounts

9. In considering the requests from various stakeholders for exemptions as "non-reporting FIs", we need to abide by the CRS criteria, mainly as follows –

(a) whether or not an FI presents a low risk of being used for tax evasion;
(b) whether it bears substantially similar characteristics to any "non-reporting FIs" under CRS; and
(c) whether it is subject to regulation or some form of information reporting to IRD.

Against the above criteria, our assessments in respect of the stakeholders' request for exemption are as follows –

Requests for exemption supported

(i) **Mandatory Provident Fund ("MPF") Schemes and Occupational Retirement Schemes registered under the respective ordinances** are substantially similar to Broad Participation Retirement Fund and Narrow Participation Retirement Fund ("non-reporting FIs" under CRS), and are subject to regulation of the respective ordinances. Since no MPF Scheme has a single beneficiary with a right to more than 5% of the fund's assets, and schemes registered under the Occupational Retirements Schemes Ordinance ("registered ORSO schemes") are employer-specific schemes which typically allow withdrawal of benefits only under certain circumstances (e.g. death or retirement of the employee), we consider that these schemes should present a low risk of being used for tax evasion. The proposed exemption will include approved pooled investment funds in the form of MPF Schemes registered under the Mandatory Provident Fund Schemes Ordinance and "pooled ORSO schemes" registered under Cap. 426 (i.e. pooling agreement among ORSO schemes) given that the risk of such pooling arrangement being used for tax evasion is low, and for "pooled ORSO schemes", the participants are confined to registered ORSO schemes only.

(ii) **Grant Schools Provident Fund and Subsidized Schools Provident Fund** are subject to regulation[2], with nature very similar to the pension fund of a Government Entity (a "non-reporting FI" under CRS). Investment of the sums surplus to the normal cash requirements is required to be made in such manner or by such method as the Financial Secretary may from time to time approve.

(iii) **Credit Unions** are subject to regulation under the Credit Unions Ordinance (Cap.119). In the Hong Kong context, credit unions possess features similar to Broad Participation Retirement Fund (which is a "non-reporting FI" under CRS). For example, most credit unions do not have a single beneficiary with a right to more than 5% of the union's assets. Funding of credit unions are contributed by their members and over 50% of its contribution is made through payments from the sponsoring employers. They present a low risk of being used for tax evasion.

Requests for exemption <u>not</u> supported

(iv) **FIs with a local client base or low-value accounts.** OECD has categorically pointed out that CRS does not include such exemption.

(v) **FIs which are charities**. They do not bear substantially similar characteristics to any of the non-reporting FIs as provided under the CRS. In particular, CRS has required that a jurisdiction cannot define an entity as "non-reporting FI" solely because it is a non-profit-making organisation.

Others

(vi) Hong Kong Securities Clearing Company Limited ("HKSCC"), HKFE Clearing Corporation Limited, the SEHK Options Clearing House Limited and OTC Clearing Hong Kong Limited. Among these four clearing houses, the last three do not fall within any of the definitions of "financial institution". As for the first one (i.e. HKSCC), it is our understanding that it is engaged in custodian services that make it fall under the definition of "custodial institution". The comprehensive nominee services provided (for example, voting, benefit entitlements distribution, notification of corporate actions or activities, etc.) make it no different from other custodians which should be caught by the CRS. Providing exemption to HKSCC would

[2] Grant Schools Provident Fund Rules (Cap. 279C) and Subsidized Schools Provident Fund Rules (Cap. 279D).

frustrate the objective of CRS.

(vii) **Share registrars.** They are not caught under the CRS definition in the first place, given that they only serve as agents of listed companies to maintain the share registers and are not involved in any business captured under the CRS.

(viii) **Investment managers / advisors and FIs which do not hold any reportable financial accounts.** FIs which maintain no financial accounts would not have any reporting obligations under the CRS.

The latest list of "Non-Reporting FIs" is set out in Annex B.

10. A few stakeholders have asked for exemption for certain types of accounts by including them as "excluded accounts"[3]. We have considered the request, similar to the approach set out in paragraph 9 above, and set out our assessment as follows –

Request for exemption supported

(a) **Dormant accounts** - Exemption is allowed under CRS (albeit only in the Commentary) for "dormant account"[4]. In the local context, it refers to an account (other than an annuity contract) with a balance that does not exceed HK$7,800.

Request for exemption not supported

(b) **Employee Incentive Share Schemes** ("ESS") ESS do not bear substantially

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[3] Under section VIII(C) of the CRS, the following are clearly set out as excluded accounts –
(a) retirement or pension account satisfying certain requirements;
(b) non-retirement tax-favoured accounts;
(c) term life insurance contracts;
(d) estate accounts;
(e) escrow accounts; and
(f) depository accounts due to non-returned overpayments as defined under CRS.

[4] An account is a dormant account if –
(a) the account holder has not initiated a transaction with regard to the account or any other account held by the account holder with the reporting FI in the previous three years;
(b) the account holder has not communicated with the reporting FI regarding the account or any other account held by the account holder with the reporting FI in the previous six years;
(c) the account is treated as a dormant account under the reporting FIs normal operating procedures; and
(d) in the case of a cash value insurance contract, the reporting FI has not communicated with the account holder regarding the account or any other account held by the account holder with the reporting financial institution in the previous six years.

similar characteristics to any "excluded accounts" under CRS. Unlike the situation in the UK, there is no legislation governing the grant of ESS in Hong Kong. In the UK, there are some requirements governing the ESS, for example, an employment relationship shall exist, an individual must not participate in certain award in a tax year, an individual shall not have "material interest", etc. The ESS in Hong Kong is not subject to these similar regulations.

(c) **Low-value preexisting accounts of insurance companies -** Preexisting account is a mandatory category covered by CRS and there is no *de minimis* rule under CRS, unless the account is an entity account which is subject to a threshold of not exceeding US$ 250,000.

The latest list of "excluded accounts" is set out in Annex C.

Scope of information to be furnished

11. Some FIs have expressed difficulties in obtaining the following information of their account holders. So long as they are required under the CRS, it would be difficult for the Government to relax the requirement –

(a) **TIN(s) and date of birth**. Whilst CRS does not require FIs to report TIN(s) or date of birth in respect of pre-existing accounts if the information is not in the records of the FIs and there is not otherwise a requirement for such information to be collected by the FIs concerned under domestic law, FIs are **required to use reasonable efforts to obtain such information** with respect to pre-existing accounts by the end of the second calendar year following the year in which such accounts were identified as reportable accounts. Regarding TIN, FIs are not required to report it if a TIN is not issued by the AEOI partner or the domestic law of the AEOI partner does not require the collection of the TIN[5].

(b) **Information on interest, dividends and proceeds from sale/redemption of financial assets.** The CRS has clearly set out the scope of reportable account information. The Government cannot deviate from the standard.

[5] As far as we understand from OECD, they will facilitate the dissemination of the TIN information with respect to the issuance, collection and, to the extent possible, the practical structure and other specifications of TINs through a centralized portal.

Due diligence and reporting requirements

A. Leveraging on existing requirements under AML and FATCA

12. We reckon the concerns raised by some FIs on the additional due diligence requirements under the AEOI, and their wish to leverage on the existing requirements under AML and FATCA as far as possible. We need to stress that due diligence for AML, FATCA and CRS serve different purposes, although CRS sets out that FIs could ride on the existing AML or Know Your Customer ("KYC") procedures to identify the personal data required from account holders for AEOI purpose where appropriate and necessary. Our response to the three specific areas highlighted is as follows –

(a) ***De minimis* rules -** While there are *de minimis* rules under the FATCA due diligence procedures and FIs need not identify and report information of low value accounts, OECD has clearly stated that it is their conscious decision not to provide for such rules in CRS. Since Hong Kong needs to comply with the CRS requirements, there is no room for Hong Kong to deviate from the standard to provide for any *de minimis* rules.

(b) **Residence address test** - The Government is prepared to allow FIs to ride on the AML/KYC procedures concerning the supporting documents for the residence address test[6]. The Government will further discuss with the regulators to facilitate smooth implementation. If necessary, IRD may elaborate the requirements in the form of guidelines.

(c) **Threshold for determining controlling persons of entities -** According to CRS, the term "controlling persons" corresponds to the term "beneficial owner" as described in the Financial Action Task Force ("FATF") Recommendations, and the FATF standard is now 25% of shares or voting rights. We intend to follow the requirements set out in CRS. The issue of aligning the standard between CRS and AML[7] will be dealt with separately.

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[6] Under HKMA's Guideline on Anti-Money Laundering and Counter-Terrorist Financing, an FI should obtain and verify the residential address (and permanent address if different) of a direct customer with whom it establishes a business relationship. Methods for verifying residential addresses may include obtaining a recent utility bill issued within the last 3 months. In other words, the documentary evidence required for satisfying the test is not confined to those issued by authorised government bodies.

[7] Under the existing Anti-money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap. 615), a beneficial owner has to control 10% of the shares or voting right.

B. Alternative options for information collection

13. In the light of views expressed to allow greater flexibility for FIs, the Government will provide in the proposed legislation the following options which are permissible under the CRS –

(a) adopting a reporting period other than calendar year, when reporting account balance or value;
(b) electing not to report gross proceeds from the sale or redemption of financial assets, in the case of custodial account, for the first reportable year;
(c) engaging service providers to fulfill their due diligence and reporting obligations;
(d) allowing flexibility or simplified rules in due diligence procedures for preexisting entity accounts, lower value accounts, group cash value insurance contracts and group annuity contracts;
(e) allowing all dollar amounts to be expressed in Hong Kong dollars and read to include equivalent amounts in any other currency;
(f) expanding the definition of "preexisting account" to cover "new account" opened by preexisting customers;
(g) expanding the definition of "related entity" to cover an entity, in relation to another entity, if they both are investment entities, and are under common management, and such management fulfills the due diligence obligations of such investment entities; and
(h) allowing exempt Collective Investment Vehicles to be qualified as "non-reporting FIs" even if they have issued any bearer shares, so long as certain prescribed conditions are met.

14. We do not see the need to provide for two other options, namely, allowing alternative approach to calculating account balances (as this might create inconsistency and confusion) and allowing greater use of existing standardized industry coding systems for the due diligence procedures (as this does not bring any apparent benefits in the local context).

C. Self-certification and Reasonableness Test

15. We acknowledge the concerns raised by stakeholders regarding the challenges to ascertain the tax residence of financial account holders. Self-certification is an important tool under CRS for FIs to fulfill its reporting and due diligence obligations, in particular to determine the tax residence of the account

holders. IRD will consider promulgating guidelines, which may include a sample self-certification form for FIs' reference[8]. We also note FIs' concerns on the reasonableness test which they are required to perform in respect of the self-certification. In the light of the examples provided in the CRS, the **essence** of the reasonableness test is that FIs need to **verify** the information of the self-certification with reference to the AML/KYC documents collected. Should there be any part of the self-certification apparently in conflict with the information as held by FIs, new self-certification form or an explanation from the account holder should be sought.

16. On the issue of whether FIs within a group could rely on a single self-certification collected by an FI in the group (since a customer may be opening accounts in multiple jurisdictions of a group), we have no strong views so long as the self-certification form can fit the purpose for the FIs to satisfy the CRS requirements, and the collection of any personal data is in compliance with the PDPO. However, as for the request of relying on other AML/KYC documents in lieu of self-certification for new accounts, the Government considers that we cannot deviate from the CRS requirements. Moreover, in the light of FIs' concerns, we will also consider whether to allow a time period for FIs to collect self-certification from account holders, with mitigation policies and measures (such as limiting the types of transactions, monitoring of accounts, and closing account upon failure to provide self-certification), to allow more flexibility for FIs.

Approach for identifying and collecting information from reportable accounts

17. One key issue flagged up in our consultation is whether FIs should be mandated to identify and keep information of accounts maintained by tax residents of the reportable jurisdictions only (i.e. those jurisdictions with which Hong Kong has entered into a Competent Authority Agreement ("CAA") for AEOI purpose) or accounts maintained by all non-Hong Kong tax residents. The majority views are that a "wider approach" should be implemented, although some are concerned about the compliance costs if it is made mandatory for all.

18. In the light of the above, we are inclined to stipulate in our law that FIs **must carry out due diligence procedures (i.e. Sections II to VII of the CRS)** to identify and collect information of **reportable accounts** with account holder's residence corresponding to the **specific reportable jurisdiction** (i.e. the jurisdiction with which

[8] Even with IRD's provision of the sample form, FIs will have the flexibility to design their own forms, provided that the forms include all essential elements required in CRS.

Hong Kong has entered into CAA), but they **may also carry out the same procedures** for accounts with account holder's residence corresponding to any **other jurisdictions outside Hong Kong**. This will provide more flexibility for FIs in choosing an approach which fits their circumstances, whilst providing those FIs pursuing the "wider" approach a clear legal basis for compliance with the PDPO. As due diligence procedures are mandatory only for reportable accounts, FIs will be sanctioned if they fail to identify, collect and report information of **reportable accounts** to IRD (but not those which choose not to identify and collect information of accounts maintained by resident of non-reportable jurisdictions, as this is permissible but not mandatory under the AEOI legislation).

19. Whilst under the above refined arrangement FIs are allowed to pursue the "wider" approach, FIs are only required to send information of the reportable accounts to IRD. For information of the non-reportable accounts, FIs will have to securely keep them as they are required under the respective regulatory and privacy regimes. As and when such jurisdictions become AEOI partners of Hong Kong, the accounts will become "reportable" and FIs will then be required to send the information of the relevant account to IRD.

Proposed penalties and proposed new powers to IRD

20. Stakeholders expressing views on the subject generally acknowledge the need for sanctions for FIs for non-compliance, but some raised concerns on whether the proposed sanctions on employees are too harsh. We consider it essential to put in place appropriate penalty provisions to provide for sufficient deterrent effect to ensure effective implementation of the AEOI regime in Hong Kong, and would therefore keep the sanctions for FIs. As regards employees, in the light of the feedback received, we propose to do away with sanctions for employees unless they have **caused or permitted the FIs to provide incorrect return in a wilful manner**. In other words, the original proposed offence of causing or permitting, without reasonable excuse, the FIs to provide incorrect return would be dropped. Moreover, since FIs may engage service providers to fulfill their due diligence and reporting obligations, we would also make it clear that the relevant sanctions would apply to such service providers for better clarity. The latest proposed sanctions for FIs, employees and service providers are at Annex D.

21. As regards the additional powers proposed for IRD for AEOI implementation, we will, in the light of the concerns expressed on the proposed power to access to the business premises and systems of FIs, make it clear in our

legislation that such power can be exercised -

(a) if the inspection is reasonably required for the purpose of checking that FI's compliance with any obligations; and

(b) upon IRD's prior notice issued to the FI.

Confidentiality safeguards and monitoring of AEOI partners' compliance

22. Whilst most stakeholders reckon the need for Hong Kong to commit to the new international standard to implement AEOI, a few questioned whether there would be sufficient confidentiality safeguards in implementing AEOI and whether the standard of "foreseeable relevance" could still be met. We would like to emphasize that Hong Kong will make use of the bilateral CDTAs/TIEAs as the legal basis for implementing AEOI. By riding on the CDTAs and TIEAs that we have signed, we would continue to rely on the relevant **safeguards** thereunder to **protect data privacy and confidentiality of the information exchanged**. The **standard of "foreseeable relevance"** will continue to be upheld in the AEOI context, as it is the overriding prerequisite under the OECD standard that the information exchanged should be foreseeably relevant to the Government and enforcement of domestic tax laws of AEOI partners. Moreover, as provided under CAA, should there be any non-compliance by AEOI partners, IRD may terminate the CAA by giving notice to the other competent authority and the termination may take immediate effect pending completion of the negative vetting process.

23. There are also concerns that the existing notification and review system in handling EOI requests and related appeals will not be applicable to the AEOI regime. We acknowledge that the modes of operation of AEOI and EOI on request are entirely different and, given the possible large number of account holders involved, it would be extremely difficult for IRD to notify each and every account holder as and when the information is exchanged. It should also be highlighted that there is no requirement for any notification system under the CRS for AEOI implementation. However, having regard to the stakeholders' concerns, we will remind the FIs that, in order to comply with the PDPO, they should inform the account holders of the possible use of the information collected for AEOI purposes and that all practicable steps shall be taken to ensure that the personal data is accurate. Account holders will be allowed to review and correct their personal and financial data.

Filing AEOI returns and IT system

24. FIs in general welcome that they can either develop their own computer software for creating files or download the software developed by IRD for preparing data files. Some FIs suggested that IRD should establish a central number for each financial account holder to facilitate their reporting. We do not think this is necessary or appropriate as account holders are required to provide their TIN(s) or equivalent (such as identity card number) corresponding to each reportable jurisdiction when they open accounts with the FI.

25. On the arrangement for FIs filing returns, IRD will issue electronic notices, through the AEOI Portal, to all registered FIs in January annually for filing AEOI Returns. FIs are required to lodge the AEOI Returns within five months. FIs would be required to file nil return if there is no reportable account for a particular year.

Choice of AEOI partners

26. Stakeholders are concerned about our priority and criteria in selecting AEOI partners for Hong Kong. Our priority now is to formulate the legislative proposals and put in place the framework for timely implementation of AEOI. At the present stage, we have no plan to conduct AEOI in one go with all our existing CDTA / TIEA partners. In identifying potential AEOI candidates from our existing or future CDTA / TIEA partners, our guiding principles are that they should have the capability in meeting the OECD standard and relevant safeguards in their domestic law for protecting data privacy and confidentiality of the information exchanged[9]. When setting our priorities, we will also take into account the bilateral trade relationship of the potential AEOI partners. We are open to advice from stakeholders on the priorities for AEOI negotiations.

27. We have also received enquiries on whether Hong Kong would make it a pre-condition for its AEOI partners to put in place tax amnesty / voluntary disclosure programmes[10]. The CRS has not made any such requirement, and Hong Kong does not intend to make this as a pre-requisite for our AEOI partners.

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[9] In this connection, OECD has developed a questionnaire to assist jurisdictions in making assessment on other jurisdictions, and will conduct review on the confidentiality and safeguards measures taken by all jurisdictions committed to implement AEOI. These will provide us with useful references.

[10] In general terms, tax amnesty / voluntary disclosure programmes are opportunities offered by tax Governments to allow previously non-compliant taxpayers to correct their tax affairs under specified terms. If these non-compliant taxpayers report their cases to their tax authorities within specified timeframe, they may face no/milder penalties.

Public education / communication campaign

28. We received suggestions that the Government should consider launching a public education / communication campaign to enhance the awareness of the general public on the AEOI regime at an earlier stage. The campaign should clearly explain the roles and responsibilities of taxpayers and FIs under the CRS requirements, in particular the tax residence concept. We will continue to work with the FI groups in this regard.

Resource issues

29. Some stakeholders are concerned if adequate resources will be provided to IRD for taking forward the implementation of AEOI, and for dealing with the possible consequential increase in EOI requests from tax treaty partners. We will closely monitor the manpower need and operation of IRD and, where necessary, provide additional resources to the department in accordance with the established practice.

Next Steps

30. We are working on the draft Bill, which will incorporate the latest features as set out in the above paragraphs, and aim to introduce the Bill into LegCo in early 2016. Subject to enactment of the legislation before end 2016, FIs will need to start conducting due diligence procedures in respect of their financial accounts in 2017. We have committed to commence the first automatic information exchanges by the end of 2018 the latest. We are working under a very tight timetable.

Financial Services and the Treasury Bureau
October 2015

Annex A

Refined Proposed Definitions for FIs

(a) A **custodial institution** means any entity that holds, as a substantial portion of **its** business, financial assets for the account of others.

(b) A **depository institution** means an authorized institution as defined under section 2(1) of the Banking Ordinance (Cap. 155); and any other entity that accepts deposits in the ordinary course of a banking or similar business.

(c) A **specified insurance company** means that any entity that is an insurance company (or the holding company of an insurance company) that issues, or is obliged to make payments with respect to, a Cash Value Insurance Contract or an Annuity Contract. It includes –

(i) an insurer authorized under the Insurance Companies Ordinance (Cap. 41);

(ii) an entity the gross income of which arising from insurance, reinsurance, and annuity contacts for the immediately preceding calendar year exceeds 50% of the total gross income for such year; or

(iii) an entity the aggregate value of the assets of which associated with insurance, reinsurances, and annuity contracts at any time during the immediately preceding calendar year exceeds 50% of the total assets at any time during such year,

that issues, or is obliged to make payments with respect to, a Cash Value Insurance Contract or an Annuity Contract.

(d) An **investment entity** means –

(i) a corporation licensed under the Securities and Futures Ordinance (Cap. 571) to carry out one or more of the following regulated activities –
- dealing in securities;
- trading in futures contracts;
- leveraged foreign exchange trading;
- asset management;

(ii) a registered institution under the Securities and Futures Ordinance (Cap. 571) to carry out one or more of the following regulated activities –
- dealing in securities;
- trading in futures contracts;
- asset management;

(iii) a collective investment scheme authorized under the Securities and Futures

Ordinance (Cap. 571);

(iv) any entity that primarily conducts as a business one or more of the following activities or operations for or on behalf of a customer –

- trading in money market instruments, foreign exchange, exchange, interest rate and index instruments, transferrable securities, or commodity futures trading;
- individual and collective portfolio management; or
- otherwise investing, administering, or managing financial assets or money on behalf of other persons; or

(v) the gross income of which is primarily attributable to investing, reinvesting, or trading in financial assets, if the entity is managed by another entity that is a depository institution, a custodian institution, a specified insurance company, or an investment entity described in subparagraph (iii) above.

Annex B

Refined list of "non-reporting FIs"

Items set out in the consultation paper in April 2015

(a) government entities (including statutory body and entities which are wholly owned by the Government), international organizations, Hong Kong Monetary Authority;

(b) pension fund of a government entity, international organization or the Hong Kong Monetary Authority;

(c) Grant Schools Provident Fund and Subsidized Schools Provident Fund;

(d) any FIs meeting the requirements defined as Board Participation Retirement Fund, Narrow Participation Retirement Fund, qualified credit card issuer, exempt collective investment vehicle or trustee-documented trust under CRS;

New items

(e) Mandatory Provident Fund Schemes registered under the Mandatory Provident Fund Schemes Ordinance (Cap.485); and Occupational Retirement Schemes registered under the Occupational Retirement Schemes Ordinance (Cap.426), including pooling agreement with participants confined to these schemes; and

(f) Credit Unions registered under the Credit Unions Ordinance (Cap.119).

Annex C

Refined list of "excluded accounts"

Items set out in the consultation paper in April 2015

(a) retirement or pension account satisfying certain requirements;

(b) non-retirement tax-favoured accounts;

(c) term life insurance contracts;

(d) estate accounts;

(e) escrow accounts;

(f) depository accounts due to non-returned overpayments as defined under CRS; and

New items

(g) dormant accounts.

Annex D

Refined list of proposed sanctions for FIs, employees and service providers

For FIs

(a) Failure to comply with the requirements for carrying out due diligence procedures, furnishing returns to IRD, or any other obligations which facilitate effective implementation of AEOI, without reasonable excuse *[Penalty: Fine at level 3 + Fine not exceeding $500 for every day or part thereof during which the offence concerning failure to furnish returns and rectify the systems continues after conviction]*;

(b) When furnishing returns to IRD:
   (i) providing information which the FI knows to be misleading, false or inaccurate in a material particular;
   (ii) provides any information and being reckless as to whether the same is misleading, false or inaccurate in a material particular; or
   (iii) providing any information that the FI has no reasonable ground to believe to be true or accurate;
   [Penalty: Fine at level 3]

(c) With intent to defraud IRD, providing misleading, false or inaccurate information in a material particular in a return furnished *[Penalty: Fine at level 3 and imprisonment for 6 months (on summary conviction); or Fine at level 5 and imprisonment for 3 years (on indictment)]*.

For employees

(d) With intent to defraud the FI or IRD, causing or permitting the FI to provide misleading, false or inaccurate information in a material particular in returns furnished with IRD *[Penalty: Fine at level 3 and imprisonment for 6 months (on summary conviction); or Fine at level 5 and imprisonment for 3 years (on indictment)]*.

For third-party service providers

(e) Failure to comply with the requirements for carrying out due diligence procedures and furnishing returns to IRD, without reasonable excuse *[Penalty: Fine at level 3]*

(f) With intent to defraud the FI or IRD, causing or permitting the FI to provide misleading, false or inaccurate information in a material particular in returns furnished with IRD *[Penalty: Fine at level 3 and imprisonment for 6 months (on summary conviction); or Fine at level 5 and imprisonment for 3 years (on indictment)]*