Hong Kong Institute of
Certified Public Accountants
香港會計師公會

By Email (AEOI Consultation) & By Hand

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AEOI Consultation
Revenue Division
Financial Services and the Treasury Bureau
(Treasury Branch)
24/F, Central Government Offices,
2 Tim Mei Avenue, Tamar
Hong Kong

Dear Sirs,

Consultation Paper on Automatic Exchange of Financial Account Information in Tax Matters in Hong Kong

The views of the Hong Kong Institute of CPAs ("Institute") on the above consultation paper are explained below.

General comments

The Institute understands that the Government of the Hong Kong Special Administrative Region ("Government") has committed to effective implementation of the common reporting standard ("CRS") developed by the Organisation for Economic Cooperation and Development ("OECD"), with the first automatic exchanges of financial account information ("AEOI") expected to take place by the end of 2018.

However, we consider that the primary purpose for implementation of AEOI (being the identification of tax evaders with financial assets and income in other jurisdictions which they are not declaring for tax) is not especially relevant for Hong Kong. This is because Hong Kong applies a territorial basis of taxation and also excludes capital gains from tax. Therefore, income and capital gains arising from foreign accounts are unlikely to be subject to Hong Kong tax. This is in contrast with jurisdictions such as the United Kingdom that generally tax worldwide income of residents and which will benefit from the identification of tax residents' financial assets abroad through increased tax revenues.

As the primary purpose for adopting the CRS is, generally, not relevant for Hong Kong, there are clearly other reasons for the Government to do so. These are stated in the consultation document as acting as a responsible member of the international community and to avoid being labelled as an "uncooperative" jurisdiction. We note, however, that very recently the European Union published a list of "non-cooperative jurisdictions" for tax transparency purposes on which Hong Kong featured, despite committing to adoption of the CRS. As a result, it is possible that adoption of the CRS may not be sufficient to address particular jurisdictions' concerns regarding Hong

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Kong's tax regime and a more productive approach may be to discuss the reasons for Hong Kong featuring on those jurisdiction's blacklists and addressing them specifically.

On this basis, the Institute considers it important that the Government has fully appraised what measures need to be taken to avoid being labelled as an uncooperative jurisdiction. Given, also, that the immediate benefits of Hong Kong's international commitment to implementing the CRS appear to be less clear cut, it will be all the more important, to control the costs of implementing the CRS, in terms of additional compliance and reporting costs for financial institutions ("FIs") operating in Hong Kong, which will ultimately be passed on to customers.

In striving to reduce the administrative cost of implementing CRS further, the Inland Revenue Department ("IRD") should provide a standard form that FIs can provide to account holders so that they may certify their tax residence. It should not be obligatory to use this form, however, as FIs may wish to use their standard global documentation. Furthermore, it is important that the CRS does not result in an extension of the IRD's information retention rights by stealth and appropriate limitation periods should be put in place, after which information must be destroyed. This is particularly relevant where an FI may collect information from all account holders in one go, even where some of it is of no particular use, due to Hong Kong's not having a competent authority agreement with the jurisdiction of residences of those account holders.

<u>Responses to specific questions</u>

We now turn to the specific questions raised. While the questions are addressed to the FIs that will need to apply the CRS and which are best placed to respond, the Institute has, nevertheless, set out below its views on the issues raised.

(a) ***FIs, non-reporting FIs and excluded accounts –*** *Do you have any views on the proposed scope of FIs (paragraph 2.12), non-reporting FIs (paragraphs 2.15 and 2.16) and excluded accounts (paragraph 2.17), within the framework allowed under CRS?*

In order to reduce the compliance burden on FIs and the ultimate cost of adopting the CRS, which will be born by customers, it is imperative that the CRS regime is harmonised with existing client and financial account information requirements to the greatest extent possible. Hong Kong has entered into a Foreign Account Tax Compliance Act ("FATCA") (on which the CRS is based) intergovernmental agreement ("IGA") with the United States, under which similar information is shared. Hong Kong also has domestic anti-money laundering legislation.

There are a number of discrepancies between the relevant definitions within the CRS and those within the FATCA IGA and the information that is required to be collected is also slightly different between the FATCA IGA, Anti-Money Laundering and Counter-Terrorist Financing (Financial Institutions) Ordinance (Cap.615)("AMLO") and the CRS.

The differences include but are not limited to:

- Exemptions for certain financial accounts or FIs in FATCA that are not in CRS, e.g., exchange traded funds regularly traded on an established securities market or FIs with a local client base.

- Requirements to report Taxpayer Identification Number ("TIN") and date of birth under CRS are not present for FATCA (both) or AMLO (TIN only).

- Different entity classifications for self certification and different ownership thresholds for controlling persons between the CRS, the AMLO and FATCA.

Therefore, we recommend that the CRS requirements be adapted to most closely align with either the FATCA or AMLO requirements, depending on which provides the most similar information to the generic CRS requirement.

(b) ***Reporting Requirements*** *– Do you have any views on the reporting requirements proposed in paragraph 2.19, within the framework required by CRS?*

As discussed above, where there are discrepancies between the information required to be provided under FATCA or AMLO and that required under the CRS, the information should be harmonised to the fullest extent possible (e.g., TIN or date of birth).

(c) ***Due Diligence Procedures*** *– Do you have any views on the due diligence procedures (including the alternative approaches to deal with certain circumstances) proposed in paragraph 3.1, within the framework required by CRS?*

We consider that the Government is taking the correct approach in placing the onus on determining the residence of an account holder on that account holder through self-certification, rather than on the FIs. However, in practice, it may prove difficult for account holders to self-certify the jurisdictions in which they are subject to tax by virtue of domicile, residence, place of management or any other similar criterion. For example, the domicile of an individual for United Kingdom tax purposes can be very difficult to ascertain and it is becoming increasingly difficult to obtain clarity from the tax authority, Her Majesty's Revenue and Customs. Therefore, is the government proposing that individuals must obtain confirmation from relevant tax authorities or professional advice on their domicile or residence status, particularly in light of penalties for making an incorrect self-certification? In our view, it would not be appropriate for individual taxpayers, under normal circumstances, to be expected to obtain legal advice or a ruling from relevant overseas tax authorities on their tax status in that jurisdiction. This being the case, in practice, most taxpayers would be able to provide FIs only with a reasonably held opinion on the matter.

(d) ***Requirement for FIs to identify and keep information of accounts concerning reportable jurisdictions*** *– Will you, as FI, identify and keep information of accounts concerning reportable jurisdictions (i.e. only those jurisdictions with CAAs with Hong Kong), or all non-Hong Kong tax resident accounts, notwithstanding the legislative*

requirement for FIs to report to IRD only information concerning reportable jurisdictions as proposed in paragraph 2.20?

We understand that many FIs would prefer to collect the required information for CRS for all of their account holders in one go (even where they are resident in a jurisdiction with which Hong Kong does not yet have a competent authority agreement). However, this raises issues of data privacy and the requirements of Personal Data (Privacy) Ordinance (Cap. 486), as the information being collected by the FIs would not be required for any purpose at that point in time (and may never be required). Therefore, FIs may require legislation permitting them to collect information that is not presently required under CRS. Customers of FIs, on the other hand, are unlikely to be willing to provide this additional information unless it is required by law. A balance must be struck between the administrative burden placed on the FIs to operate the regime and the data privacy rights of the customers. It should also be borne in mind that taxpayers might find it difficult to accept that, in principle, they could face sanctions for incorrect self-certifications, where the relevant information was not required to be submitted to any overseas tax authority.

(e) ***Proposed sanctions*** *– Are the proposed sanctions proportionate to the types of offences (paragraphs 2.24 and 2.25)? Do you agree that we should impose sanctions on individual account holders who make false self-certification (paragraph 2.26)?*

The Institute understands the need (and requirement under the OECD's CRS) for effective implementation offences that are criminal rather than civil and apply where information has not been exchanged under the regime or the information is incorrect. As indicated above, there is, however, no loss of tax in Hong Kong and it is not even necessarily the case that tax is being evaded in the foreign jurisdiction. As such, criminal penalties would appear to be overly severe for failure to report information correctly (rather than tax evasion itself).

In particular, the offence in relation to employees of FIs for causing or permitting the FI to fail to comply with the requirements imposed on FIs, or to make incorrect returns, without reasonable excuse, seems unduly punitive. It is not clear that where an employee makes an inadvertent mistake that that would constitute a reasonable excuse. Given also that this proposal would appear to put the burden of proof on the employee, we would envisage that it would become very difficult for FIs to fill roles where employees might face this responsibility. The position can be contrasted with offences under the AMLO, on which we understand the proposed sanctions are based. Under the AMLO, an employee is expected to give specific consideration to particular transactions and is, therefore, more likely to commit an offence either deliberately or recklessly. We also note that the AMLO is new legislation and so there is little, if any, practical experience, regarding how the offence provisions will operate.

Furthermore, as the penalties are applied for each failure, where there is a systemic issue, it could result in tens of thousands of errors. As such, a more proportionate approach would be to ignore errors below a certain threshold number of accounts or set a maximum penalty for offences arising from the same issue.

On balance, however, we would recommend that the proposed offence of causing or permitting the FI to fail to comply with the requirements imposed on FIs, or to make incorrect returns without reasonable excuse, be dropped in relation to employees.

As regards self-certification by account holders, we do not consider it necessary to introduce additional penalties or offences. The current provisions of the Inland Revenue Ordinance, making it an offence to provide incorrect information as part of exchange of tax information, without reasonable excuse, should be sufficient. However, it should be a requirement for FIs to inform account holders when requesting self-certifications that this offence exists.

(f) ***Confidentiality and notification*** *– Does your institution have in place any mechanism to update clients' information and to meet the confidentiality safeguards (paragraph 2.33)?*

FIs should notify any existing and new account holders that their account information may passed to the IRD for exchange with foreign jurisdictions, where the account holder is tax resident, in compliance with the relevant legislation. The account holder should also be informed of the type of information that may be exchanged and of other important requirements of the legislation (e.g., if there is a requirement for account holders to notify the FI of any changes to their residence status (see below)).

While there may be situations where FIs have in place processes to regularly update the client information, they may not cover the situation where account holders' tax residence status changes or they acquire a new tax residence, or relinquish an existing one. In order for the financial information to be exchanged to be complete and accurate, it is important that it be up to date. The onus for ensuring this must rest on the account holder rather than the FIs and, as such, the Government may consider introducing a statutory requirement for account holders to maintain their information held with the FIs.

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It is also important to consider whether the account holder information provided by the FIs contains errors or omissions through no fault of the account holder. As the IRD has specifically excluded the possibility that it will confirm the information of account holders before exchanging it with their jurisdictions of residence (as it currently does with manual requests for information from other jurisdictions), there should be a mechanism for account holders to ensure that the correct information about them is being submitted to foreign tax authorities. If practicable, FIs should be required to send a copy of the information to be reported to both the IRD and the relevant account holder at the same time. If it is not feasible for every account holder to be provided with a copy of the information that the FI plans to furnish regarding them in advance of the FI doing so, it should be a requirement for FIs to provide a statement of the information furnished to each account holder, as soon as practicable, after the reporting. There should be appropriate mechanisms to allow for inaccurate or incomplete information, whether in the hands of an FI or the IRD, to be corrected and for supplementary transmissions of corrected information to be provided to foreign jurisdictions. It follows that account holders should also have the right to obtain a copy of their information in the IRD records and should be able to request the IRD to correct any errors that may have occurred after the information was received by the

IRD.

In addition, there should be reasonable means of dealing with any disputes between FIs and account holders regarding the accuracy of information sent or to be sent to the IRD.

(g) ***IT system*** *– Will you, as FIs, use your self-developed software or the IRD software for preparing the data files of AEOI Returns? What are the considerations involved (paragraph 3.9)?*

No specific comments.

(h) ***Other matters***

The Institute agrees with the proposal in the consultation paper that, if AEOI proceeds on the basis of bilateral exchanges with treaty partners (i.e., jurisdictions with which Hong Kong has a comprehensive double taxation or tax information exchange agreement), the Government should first assess the capability of those treaty partners to meet the OECD standard, including having in place appropriate laws and rules to safeguard data privacy and confidentiality. Of course, the Government should already have assessed the ability of treaty partners to safeguard the data privacy and confidentiality of information exchanged upon request, and so this may require only a supplementary assessment of how the relevant jurisdictions are able to handle large quantities of information transmitted in bulk.

In relation to the above, we should like to seek clarification as to how the Government will conduct ongoing monitoring of treaty partners' compliance with the OECD standard.

Should you have questions on this submission, please feel free to contact me on 22877084 or at peter@hkicpa.org.hk

Yours faithfully,

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