A global move to automatic exchange of financial account information

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In brief

On 13 February 2014, the Organisation of Economic Cooperation and Development (OECD) released a new global standard for automatic exchange of financial account information ("the new standard") between governments. The new standard consists of two components: (1) the Common Reporting Standard (CRS) which contains reporting and due diligence rules and (2) the Model Competent Authority Agreement (CAA) which helps to execute the automatic exchange of information (AEoI) in an effective way. More than 40 countries have since then committed to early adoption of the CRS and AEoI among G20 members is expected to begin by the end of 2015.

As we mentioned in our earlier News Flashes, Hong Kong will be under immense pressure to rethink its current policy of exchanging information upon request only and to move to AEoI which is the latest international standard on information exchange.

Before Hong Kong can adopt the CRS, the HKSAR Government will need to put in place a legal framework for AEoI and an effective administrative system to implement such information exchange in practice. In view of the possible adoption of the CRS in Hong Kong in the future, financial institutions (FIs) should assess whether their existing compliance and information systems are flexible enough to accommodate the additional reporting and due diligence obligations under the CRS. For taxpayers in general, the boosted international transparency under the CRS will serve as another deterrent to the use of offshore accounts, by both individuals and entities, to avoid domestic tax liabilities.

In detail

Scope of the CRS

Under the new standard, competent authorities are required to automatically exchange the information reported by FIs with other jurisdictions on an annual basis. Entities that need to report and information to be reported include:

- **Who to report:** The reporting FIs cover not only banks but also brokers, certain collective investment vehicles and certain insurance companies.

- **Whose account information is collected:** The reportable persons under the CRS include both individuals and entities (which include trusts and foundations). FIs are required to look through passive entities such as shell companies, trusts or similar arrangements to report on the ultimate controlling persons of these entities according to the guidelines provided in the due diligence procedure.

- **What kind of information is collected and exchanged:** The information to be exchanged includes all types of investment income (including interest, dividends, income from certain insurance products, sales proceeds from financial assets, and other income generated with respect to assets held in the accounts) as well as account balances and payments made with respect to the accounts. It also includes general information such as the name, address, jurisdiction of residence, date and place of birth (for an individual), etc. with respect to each reportable account.

The massive information required to be reported and exchanged under the CRS will enable tax authorities to conduct various assessment activities (e.g. tax registration, completeness and accurateness of tax filing, affordability of tax bills, etc.).
The due diligence procedures

In order to ensure the quality of the information exchanged, the Annex to the CRS prescribes the due diligence procedures that FIs must follow to identify reportable accounts from their pre-existing and new accounts. The criteria to be used to identify reportable accounts vary depending on whether the account is a pre-existing or new one as well as whether the account holder is an individual or an entity.

Although these procedures seem to be very complicated, they give clear guidance to FIs to develop their internal compliance standard and system.

The Model CAA

The Model CAA links the CRS with the legal basis for AEoI (such as a tax treaty or the Convention on Mutual Administrative Assistance in Tax Matters) such that financial information obtained by competent authorities from FIs under the standard can be exchanged on an automatic basis pursuant to the legal instrument on AEoI.

The Model CAA contains provisions that set out the type of information to be exchanged, the time and manner of exchange and the confidentiality and data safeguards that must be observed, etc.

CRS vs US Foreign Account Tax Compliance Act (FATCA)

Similar to the US FATCA, the CRS will require FIs around the globe to play a central role in providing tax authorities with greater access and insight into taxpayers’ financial account data including income earned in these accounts. Since the CRS requests all territories to jointly establish a global automatic information exchange system, the CRS could have wider implication than FATCA.

The CRS also contains different features as compared with the US FATCA, e.g. legal instrument, reportable person, minimum threshold, etc. Further, the CRS does not include withholding tax sanction as prescribed in FATCA. These differences may potentially increase compliance costs for FIs.

What does the CRS mean for Hong Kong?

Currently, Hong Kong’s policy on EoI is to exchange information upon request only. The revised Departmental Interpretation and Practice Notes No.47 on Exchange of Information, which was issued in January 2014, indicates that “Hong Kong has not yet agreed to exchange information on an automatic or spontaneous basis”.

However, given that more than 40 countries have committed to early adoption of the CRS and AEoI among G20 members is expected to begin by the end of 2015, Hong Kong will need to consider how it should position itself amidst the global move to AEoI and the increased pressure on greater transparency as advocated under Base Erosion and Profit Shifting (BEPS). In this regard, it is expected that there will be public discussions on AEoI in Hong Kong in the coming months.

If Hong Kong is going to adopt the CRS, the HK SAR Government will need to put in place a legal framework for implementing AEoI. This may involve the following:

- Incorporating the CRS as part of the domestic law.
- Concluding a legal instrument on AEoI4 with jurisdictions that do not currently have a comprehensive double tax agreement (CDTA) with Hong Kong.
- Amending the EoI article of the existing CDTAs of Hong Kong that do not impose an obligation on the contracting parties to exchange information on an automatic basis5.
- Amending the existing Inland Revenue (Disclosure of Information) Rules to cover AEoI.

The takeaway

The development of CRS is in line with the trend to reinforce international cooperation in tax matters and improve tax information transparency. It is another ambitious global tax project complementing the action plans on BEPS. The OECD is currently developing detailed commentary for the CRS and technical solutions for implementing the actual information exchange, both of which are expected to be released in September this year. This will hopefully explain how the CRS is to be implemented and strike a balance between compliance in practice and minimising the costs of implementation.

For the HK SAR Government, a legal framework for AEoI will need to be put in place before Hong Kong can adopt the CRS and additional resources will be required to effectively implement AEoI in practice.

For the financial industry, the CRS will impose significant additional reporting and due diligence obligations that result in extra costs of compliance. Financial institutions that are working towards compliance with the US FATCA regime, which will be in operation from 1 July 2014, should assess whether their current FATCA compliance plans and systems are flexible enough to accommodate the obligations under the CRS should Hong Kong decide to adopt the standard.

For taxpayers in general, the boosted international transparency under the CRS will serve as another deterrent to the use of offshore accounts, by both individuals and entities, to avoid domestic tax liabilities.

Endnotes

3. We understand that there will be a presentation by the representatives from the OECD on AEoI in Hong Kong next month and at least two seminars on similar topics by academic institutions will be held in these two months.
4. The EoI Article (Article 26) of the OECD Model Tax Convention is silent on whether information should be exchanged on request or automatically. However the commentary to Article 26 makes it clear that one of the ways for information exchange is on an automatic basis. Contracting parties may restrict the ways of information exchange and some of the existing HK CDTAs have this restriction (see endnote 5 below). AEoI is also possible under Article 6 of the Convention on Mutual Administrative Assistance in Tax Matters but currently Hong Kong is not a
signatory to this Convention. The current version of the OECD Model Tax Information Exchange Agreement (Article 5) explicitly states that the exchange of information is upon request.

5. Although the OECD model EoI Article does not limit or commit the contracting parties as to the forms or manner in which information exchange can take place, many of the existing CDTAs of Hong Kong contain provisions in the protocol stating that the EoI article does not oblige/commit the contracting parties to exchange information on an automatic or a spontaneous basis. Examples are CDTAs with Canada, France, the Netherlands, New Zealand, Portugal, Switzerland and the UK.
News Flash — Hong Kong Tax

Let’s talk

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