



# CRS in Hong Kong: Will it be effective in cracking down international tax evasion ?

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5 February 2018

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# Speaker

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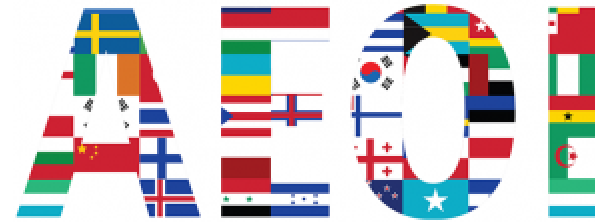
Clayton is a Certified Public Accountant (Practising) in Hong Kong, and a Certified Fraud Examiner in USA. He has years of combined experience in performing public auditing, advising tax efficient onshore/offshore structure for HK companies, contesting tax field audits and tax investigations, and conducting financial due diligence and investigative accounting. He has also been involved personally in attestation engagements for small and closely held companies, local and national businesses, and public held enterprises listed in US, Japan, Australia, Singapore, South Korea, China and Hong Kong.

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# Overview of AEOI



- Automatic Exchange of Financial Account Information (AEOI) in HK: A quick recap and update
  - ❑ OECD: Released in July 2014 the AEOI in Tax matters
  - ❑ To exchange financial account information with jurisdictions of residence of account holders on an annual basis.
  - ❑ To enhance tax transparency and combat cross-border tax evasion
  - ❑ To promote a more efficient mode of international tax cooperation

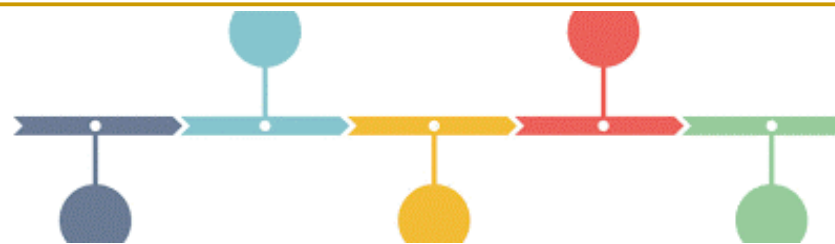
# Overview of AEOI



## ■ Two Parts of AEOI

- ❑ Common Reporting Standard (“CRS”): Reporting and due diligence requirements
- ❑ Model Competent Authority Agreement: Detailed procedures on the exchange of information
- ❑ Under the CRS, financial institutions are required to identify financial accounts held by tax residents of reportable jurisdictions or held by passive non-financial entities whose ‘controlling persons’ are tax residents of reportable jurisdictions. The relevant information of these accounts will be collected by the financial institutions and sent to IRD, and annually such information will be transmitted automatically to the tax authorities of the jurisdictions with which Hong Kong has signed the competent authority agreement (i.e. “AEOI partners”).

# Overview of AEOI



## ■ Timeline of AEOI implementation in Hong Kong

- ❑ July 2017: IRD launched AEOI portal for financial institutions to submit the account information
- ❑ May 2018: First AEOI returns to be filed with IRD by the financial institutions (for calendar year 2017)
- ❑ Sept 2018: Information (for calendar year 2017) to be transmitted to the tax authorities of the reportable jurisdictions
- ❑ Dec 2018: automatic exchange of information in relation to calendar year 2018.
- ❑ Hong Kong will only conduct AEOI with a reportable jurisdiction when an arrangement is in place with the reportable jurisdiction concerned to provide the basis for exchange

- Inland Revenue (Amendment) (No.5) Bill 2017
  - Gazetted on 6 October 2017
  - CE in Council will have the power to give effect to multilateral tax agreements
  - A move from bilateral basis to multi-lateral basis as regards AEOI---a "reportable jurisdiction" is no longer a party to a tax treaty or a tax information exchange agreement with Hong Kong; any jurisdiction that is specified as such in the Inland Revenue Ordinance would be a reportable jurisdiction.

# Overview of AEOI



- Reportable jurisdictions (as of 16 Oct 2017)
  - 75 jurisdictions in respect of the financial account information of tax residents for the first information period from 1 July 2017 to 31 December 2017 (UK and Japan: from 1.1.2017 to 31.12.2017; Korea: from 1.1.2018 to 31.12.2018)
  - 15 jurisdictions as AEOI partners (Belgium; Canada; Guernsey; Ireland; Indonesia; Italy; Japan; Korea; Mexico; the Netherlands; New Zealand; Portugal; South Africa; Switzerland; UK)



# Overview of AEOI



- “Tax residents of reportable jurisdictions” refer to those who are liable to tax by reason of residence in the jurisdictions:
  - *an individual: the person’s physical presence or stay in a place (e.g. whether over 183 days within a tax year)*
  - *a company: the place of incorporation or the place where the central management and control of the entity is exercised.*

# Overview of AEOI

## ■ Financial institutions

- ❑ banks
- ❑ assets managers
- ❑ custodial institutions
- ❑ depository institutions
- ❑ specified insurance companies

## ■ Reporting financial institution

- ❑ a financial institution resident in Hong Kong or a branch of a non-resident financial institution located in Hong Kong



# Overview of AEOI



## ■ Information to be exchanged

- ❑ relates only to the tax residents of the jurisdictions of the AEOI partner
- ❑ name, address and other identifying information of the reportable persons (e.g. date of birth, nationality, tax identification number)
- ❑ details of the financial institution
- ❑ account number
- ❑ balance or value of the account
- ❑ dividend, interest income, income from certain insurance products, sales proceeds from financial assets.

# Overview of AEOI



## ■ CRS Self-declaration

- ❑ the reporting financial institutions are required to perform due diligence procedures and to transmit systematically financial data from their non-resident customers
- ❑ For accounts opened on or after 1 January 2017: account holders to provide a self-declaration
- ❑ For accounts opened before 1 January 2017: account holders may be asked by the reporting financial institutions to provide a self-certification in order to verify their tax residency

# Overview of AEOI



## ■ Due diligence

- ❑ Mandatory requirement for a reporting financial institution to establish, maintain and apply due diligence procedures to identify account holders (including controlling persons of the accounts) who are tax residents in reportable jurisdictions (but not other accounts held by residents of non-reportable jurisdictions).
- ❑ The due diligence procedures can also be applied for a financial account where the account holder is a tax resident in a territory outside Hong Kong, which is not a reportable jurisdiction.
- ❑ Reporting financial institutions will be sanctioned only if the information of “reportable accounts” to IRD is not properly collected and submitted.

# Overview of AEOI

## ■ Controlling persons

Sections 50A(1) and (6) of the Inland Revenue Ordinance

- ❑ An individual who exercises control over an entity
- ❑ A settlor, trustee, protector, beneficiary etc. in a trust
- ❑ Control can be direct, indirect or ultimate
- ❑ Specified percentage of ownership: not less than 25%\*

*[\* to be amended as “more than 25%” under the Inland Revenue (Amendment) (No. 5) Bill 2017]*



# Overview of AEOI



## FATF Guidance on “Transparency and Beneficial Ownership” Oct 2014

Who are the beneficial owners?

- Natural persons who may control the legal person through ownership interests
  - The natural person(s) who directly or indirectly holds more than 25 percent of ownership interest in the legal person.
  - Shareholders who exercise control alone or together with other shareholders, including through any contract, understanding, relationship, intermediary or tiered entity.
- Natural persons who may control the legal person through other means
  - The natural person(s) who exerts control of a legal person through other means
  - The natural person(s) who exerts control without ownership
- Natural persons who may exercise control through positions held within a legal person
  - The natural person(s) responsible for strategic decisions that fundamentally affect the business practices or general direction of the legal person
  - The natural person(s) who exercises executive control over the daily or regular affairs of the legal person through a senior management position

# Overview of AEOI

## Reportable Person-Case 1



a tax resident of Country X  
(AEOI partner)



100%



a company (passive NFE)  
incorporated in Country X  
(AEOI partner)

**[REPORTABLE ?]**



# Overview of AEOI

## Reportable Person-Case 2



a tax resident of Country Y  
(non-AEOI partner)



100%



a company (passive NFE)  
incorporated in Country Y  
(non-AEOI partner)

**[REPORTABLE?]**

# Overview of AEOI

## Reportable Person-Case 3



a tax resident of Country A  
(AEOI partner)



100%

Company Z

a company (passive NFE)  
incorporated in Country B  
(non-AEOI partner)

**[REPORTABLE ?]**

# Overview of AEOI

## Reportable Person-Case 4



a tax resident of Country B  
(non-AEOI partner)



100%

Company W

a company (passive NFE)  
incorporated in Country A  
(AEOI partner)

**[REPORTABLE ?]**

# CRS: Due diligence and collection of information



- Typical information to be collected by the FI for a reportable account (a passive NFE)
  - ❑ Type of organization
  - ❑ Country of incorporation
  - ❑ Listed entity or private company
  - ❑ Regulated entity
  - ❑ Registered shares or bearer shares
  - ❑ Nature of business, types of products/services
  - ❑ Internet website
  - ❑ Business address: why home address or a shared office?
  - ❑ Significant change of ownership, directorship, company name, business address, business operation etc. in the past 5 years
  - ❑ Parent company: corporate information and ownership details
  - ❑ Name of auditor/external CPA
  - ❑ Latest audit year end: why no audited accounts?
  - ❑ Initial source of wealth
  - ❑ Ongoing source of wealth

# CRS: Due diligence and collection of information



- ❑ Turnover for the past 12 months
- ❑ Estimated turnover for the next 12 months
- ❑ Estimated assets size/assets management size
- ❑ Number of employees-in HK and overseas
- ❑ Reasons of no employees
- ❑ Reasons for keeping the bank account if no employees
- ❑ Any account opened with other banks in HK and overseas
- ❑ Any HK or overseas branches and subsidiaries
- ❑ Estimated revenues/expenses by major geographical areas
- ❑ Transactions with UN-sanctioned countries
- ❑ Reliance on major customers (over 50% of the turnover)

# CRS: Due diligence and collection of information



- ❑ Type of principal banking services used
- ❑ Cross-border transactions: reasons, types, frequency, amounts, countries involved
- ❑ Cash deposit
- ❑ Yearly minimum bank balance to be kept and the minimum number of bank transactions
- ❑ Connected parties: name, address, DOB, nationality, passport number etc., relationship with the reporting entity
- ❑ Position of the connected parties: beneficial owner, shareholder, authorised account signatory, director, partner, senior manager etc.
- ❑ Beneficial owner: shareholding, initial and ongoing source of wealth, business experience
- ❑ Bank account signatory: a shareholder? a sole signatory? why sole signatory?

# CRS: A hypothetical case



## Summary of certain statutory requirements

### ■ Business Registration Ordinance [“BRO”]

- Section 5 (1): every person commencing to carry on any business, or carrying on any business to which the BRO is made to apply shall make application to the Commissioner of Inland Revenue for the registration of that business.

"Business" required to be registered includes:

- any form of trade, commerce, craftsmanship, profession, calling or other activity carried on for the purpose of gain;
- any club which provides facilities, services and exclusive club premises to its members for social intercourse or recreation;
- every company incorporated in Hong Kong under the Companies Ordinance or non-Hong Kong company that has established a place of business in Hong Kong, regardless of whether it is actually carrying on any business in Hong Kong; and
- every non-Hong Kong company that has a representative or liaison office in Hong Kong, or has let out its property situated in Hong Kong, regardless of whether it has established a place of business in Hong Kong.

# CRS: A hypothetical case



- Companies Ordinance [“CO”]  
Registration of a non-Hong Kong company under Part 16 of the CO
  - ❑ A non-Hong Kong company, which is a body corporate and has established a place of business in Hong Kong, is required to register pursuant to Section 776 of Part 16 of the CO.
  - ❑ An application for registration is to be made within one month after the establishment of the place of business in Hong Kong. Business Registration Certificate will only be issued to a registered non-Hong Kong company which has not yet registered its business under the BRO.
  - ❑ Section 776: a non-Hong Kong company is required to apply for registration as a “registered non-Hong Kong company” within one month after the establishment of the place of business in Hong Kong. Amongst other documents and information, details such as the company’s name, the address of the principal place of business in Hong Kong, particulars of directors, company secretary and authorized representative in Hong Kong etc. have to be delivered to the Registrar of Companies for registration.



# CRS: A hypothetical case



- Companies Ordinance [“CO”]  
De-registration of a Hong Kong company under Part 15 of the CO.
  - The company must meet the following conditions before making an application for deregistration:
    - (a) all the members of the company agree to the deregistration;
    - (b) the company has not commenced operation or business, or has not been in operation or carried on business during the 3 months immediately before the application;
    - (c) the company has no outstanding liabilities;
    - (d) the company is not a party to any legal proceedings;
    - (e) the company’s assets do not consist of any immovable property situate in Hong Kong;
    - (f) if the company is a holding company, none of its subsidiary's assets consist of any immovable property situate in Hong Kong; and
    - (g) the company has obtained a "Notice of No Objection to a Company being Deregistered" from the Commissioner of Inland Revenue.

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## CRS: A hypothetical case

- ❑ Section 752 (1) of the CO: The company will be dissolved on deregistration and, upon dissolution, all the company's property, if any, is vested in the Government of the Hong Kong Special Administrative Region as bona vacantia.
- ❑ Section 750 (6) of the CO: a person who, in connection with an application, knowingly or recklessly gives any information to the Registrar of Companies that is false or misleading in a material particular commits an offence and is liable (a) on conviction on indictment to a fine of \$300,000 and to imprisonment for 2 years; or (b) on summary conviction to a fine at level 6 and to imprisonment for 6 months.

# CRS: A hypothetical case



Mr. A\*

- Mr. A is the sole shareholder and a director of A Ltd
- A Ltd is a manufacturer of certain products in Country X
- Country X is an AEOI partner
- A Ltd sold the products to a key customer in Country Y previously

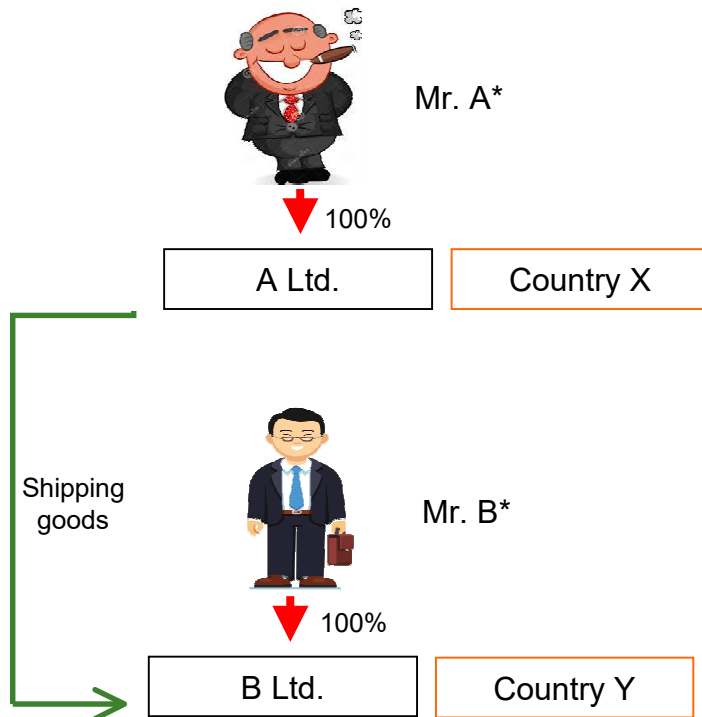


100%

A Ltd.

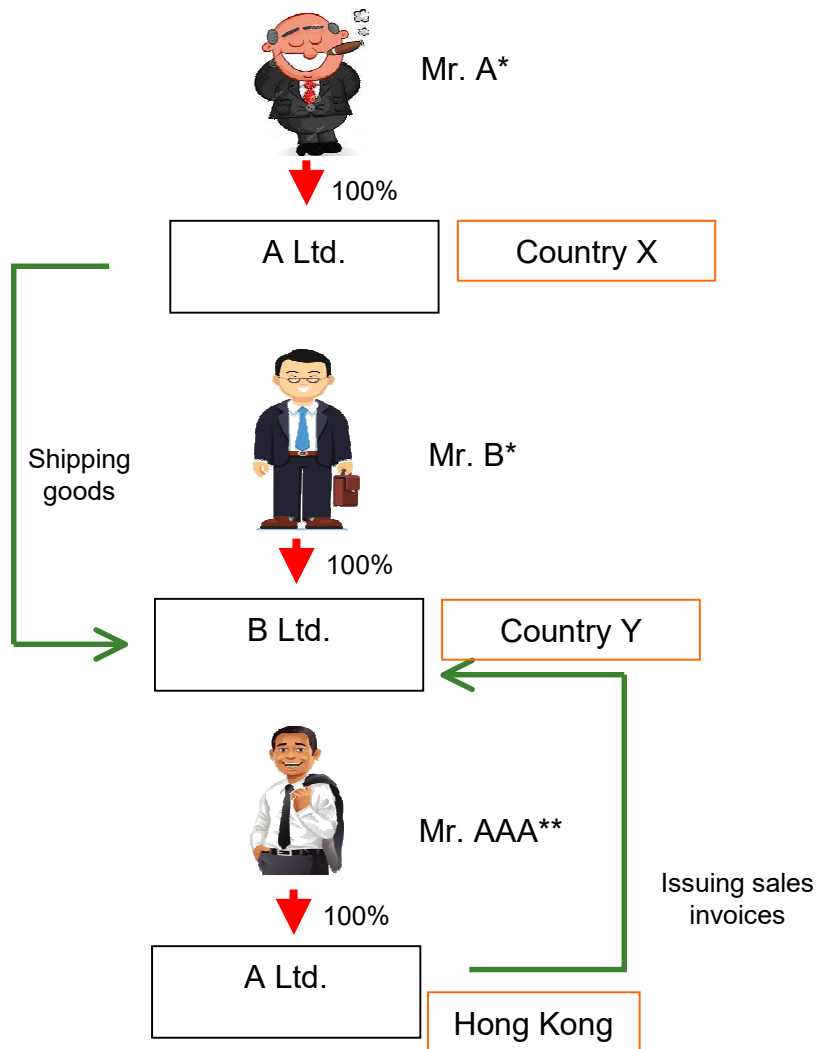
Country X

# CRS: A hypothetical case



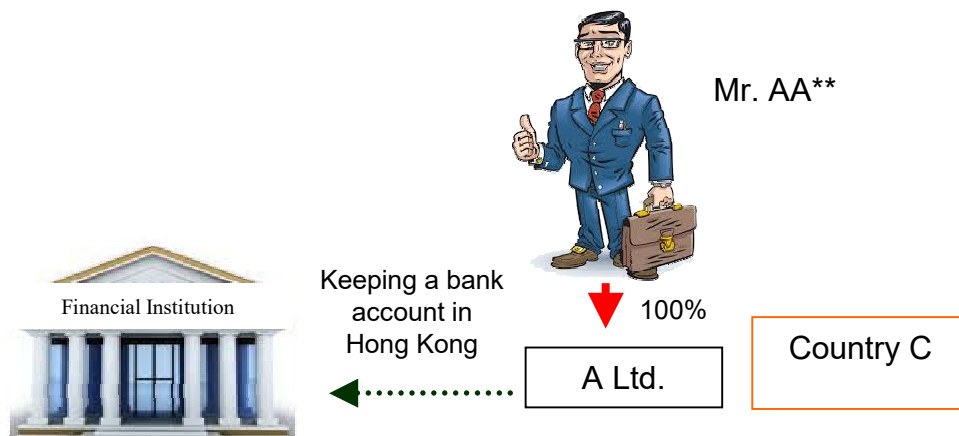
- Mr. B, who is an unrelated individual with Mr. A, owns B Ltd in Country Y
- B Ltd issues purchase orders to A Ltd
- Goods are shipped directly from Country X to Country Y
- Previously A Ltd issued sales invoices to B Ltd
- B Ltd sent payment from its bank account in Country Y to A Ltd's bank account in Country X

# CRS: A hypothetical case



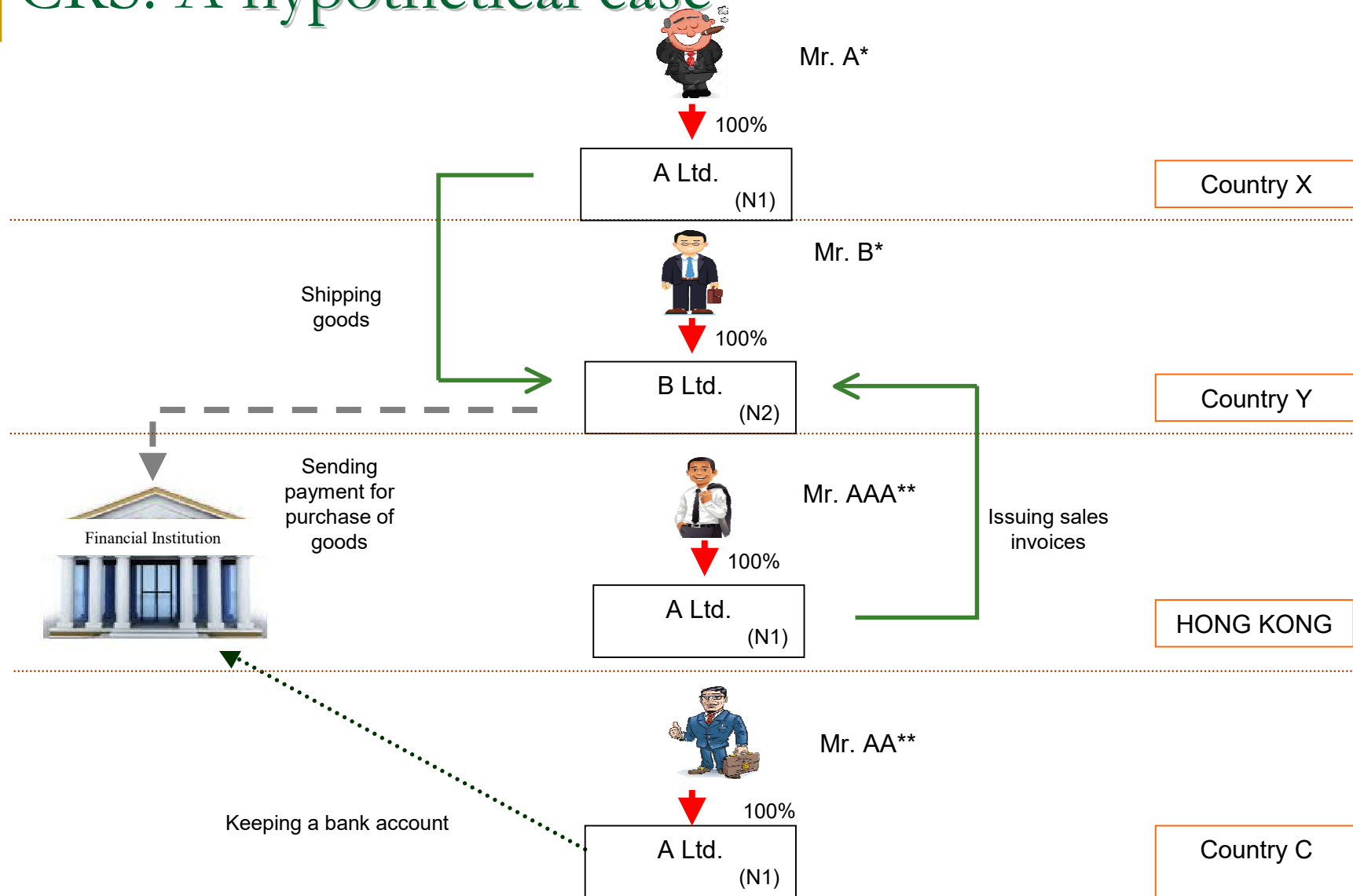
- On Mr. A's request, Mr. B was asked to accept sales invoices issued by another A Ltd, a company incorporated in Hong Kong ["HK-A Ltd"] with a name same as that of A Ltd incorporated in Country X ["X-A Ltd"]
- Mr. A represented to Mr. B that the HK-A Ltd belonged to the same group of companies owned by X-A Ltd
- Mr. AAA is the sole director and shareholder of HK-A Ltd
- Mr. AAA is a relative of Mr. A
- B Ltd accepts the sales invoices purportedly issued by HK-A Ltd
- A bank account number is given on those sales invoices
- The name of bank account holder appears to be HK-A Ltd
- B Ltd has been sending payment from its bank account in Country Y to the bank account in Hong Kong
- HK-A Ltd was subsequently dissolved by way of deregistration without Mr. B's knowledge
- HK-A Ltd continues to issue sales invoices to B Ltd after deregistration

# CRS: A hypothetical case



- Mr. AA, who is a manager working for Mr. A, set up another company also known as A Ltd in Country C ["C-A Ltd"] a few years ago
- Country C is a non-AEOI partner
- C-A Ltd did not apply for a business licence in Hong Kong, nor did it register as a non-HK company under Part 16 of the CO
- C-A Ltd opened a bank account in Hong Kong, and its account number is quoted on the sales invoices purportedly issued by HK-A Ltd
- Mr. A is the sole signatory of the said bank account

# CRS: A hypothetical case



N1: Identical company names

N2: An Independent third party

\* : Mr. A is the sole authorised signatory of the HK bank account

\*\* : They are the "nominees" of Mr. A.

## CRS: A hypothetical case



- How could the bank possibly identify the suspicious account activities from the CRS self-declaration form and the account review questionnaire provided by C-A Ltd?
  - ❑ No business registration in HK
  - ❑ Not registered as a non-HK company under the CO
  - ❑ No physical office in HK
  - ❑ No employees in HK
  - ❑ No audited financial statements
  - ❑ Fund sending from overseas and from the same party throughout the year
  - ❑ Receipts on behalf of a connected person
  - ❑ Large cash withdrawals
  - ❑ Mr. A : a controlling person of C-A Ltd
  - ❑ Authorised signatory but not the director or shareholder
  - ❑ S. 80(2E) of the IRO: An offence in making a self-declaration with misleading, false or incorrect information



# CRS: A hypothetical case

- Legal implications for HK-A Ltd:

- Deregistration
- Tax offences
- Money laundering



- Further implications for:

- X-A Ltd
- B Ltd
- C-A Ltd

## 1. Country-by-Country (“CBC”) Reporting

- ❑ Inland Revenue (Amendment) (No. 6) Bill 2017 was gazetted on 29 December 2017
- ❑ MNE is required to file a CBC report for an accounting period where consolidated group revenue for the preceding period is at least EUR 750 million (HK\$6.8 billion); and the group has constituent entities or operations in 2 or more jurisdictions
- ❑ The Report will be exchanged automatically between tax authorities under the relevant exchange arrangements
- ❑ Multilateral Convention is not applicable in Hong Kong for the time being, exchange of CBC Reports will be made under bilateral arrangements with jurisdictions currently having CDTAs with Hong Kong, i.e. France, Ireland, South Africa, and UK (all with CBC report for first exchange in respect of 2016)

# Moving forward



## 2. Significant Controllers Register (“SCR”)

- ❑ Companies (Amendment) Ordinance 2018, operative on 1 March 2018
- ❑ A company incorporated in HK to maintain updated beneficial ownership information by keeping a SCR
- ❑ SCR available for inspection by law enforcement officers upon demand
- ❑ Particulars of significant controllers to be recorded
- ❑ “Significant control” over a company: 5 conditions



**QUESTIONS?**  
**THANK YOU !**