

Hong Kong AEOI Updates

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With the Hong Kong Inland Revenue Department's (HKIRD) onsite Common Reporting Standard (CRS) compliance inspection as their ongoing initiative, coupled with the implementation effectiveness agenda on CRS compliance from the Organisation for Economic Co-operation and Development (OECD) as well as the evolving regulatory framework introducing more due diligence and reporting requirements, there is no time better than the present for Hong Kong Reporting Financial Institutions (HKRFIs) to reevaluate their Automatic Exchange of Financial Account Information (AEOI) compliance programs.

In this article, we shall highlight the HKIRD's key focus review areas in respect of CRS compliance via onsite inspections, as well as the upcoming legislation updates to the CRS.

HKRFIs which have incorporated CRS compliance as part of their Business-As-Usual since the launch of CRS in Hong Kong in 2017 should now be prepared to return to Project mode in order to stay compliant and competitive in the market.

OECD's Peer Reviews & HKIRD's onsite CRS inspections

Starting from 2023, the OECD has commenced the Second round of AEOI Peer Reviews among all participating jurisdictions around the globe. OECD's assessment team comprising of the OECD Global Forum Secretariat together with the representatives of the designated peer participating jurisdictions came to Hong Kong in late May 2024 to interview the HKIRD and other representatives from the government and financial industry to assess Hong Kong's effective implementation of the AEOI Standard. The results of the AEOI Peer Reviews are expected to be finalised and published in 2025.

Since the first receipt of CRS data from HKRFIs in 2018, the HKIRD has begun reviewing such data and sending enquiry letters together with standardised questionnaires to the HKRFIs, reviewing, among other things, the robustness of their due diligence processes and the data integrity of reportable information (e.g., working paper of tax residency and controlling person determination, availability of the Taxpayer Identification Numbers (TINs) and dates of birth). Over the years, numerous HKRFIs have even received more than one enquiry letter from the HKIRD on an annual basis. Such continuous effort demonstrates that the HKIRD is determined to ensure robust AEOI compliance in Hong Kong.

In February 2024, the OECD Global Forum Secretariat launched the Model Manual for CRS Compliance Audits which provides reference to the tax authorities of participating jurisdictions when developing, improving, or implementing their own procedures and methodologies for conducting CRS compliance audits. Since then we saw the HKIRD springing into action initiating and lining up onsite inspections with HKRFIs of all types. We observed that HKIRD's AEOI onsite inspections are structured to comprehensively assess the robustness of HKRFI's CRS compliance status given the broad coverage of the CRS compliance requirements impacting the entire business operations of the HKRFIs. Based on our observations, the key activities and the focus of HKIRD's CRS onsite inspections are set out as follows:

- ▶ Management presentation should be well prepared to demonstrate the robustness of the real-life CRS processes in detail, including but not limited to the due diligence (e.g. application of "standard of knowledge / reason to know" and other fundamental CRS principles) and reporting obligations (e.g. reporting preparation and review procedures).
- ▶ Governance and control framework should be explained against the corresponding business complexity.
- ▶ Technological usage should be presented and, if necessary, a walk-through might be required.
- ▶ Various CRS risk areas, particularly those which are industry-specific, might be asked for explanation.
- ▶ CRS data quality and integrity, e.g. availability and formats of TINs, dates of birth and incomplete addresses.
- ▶ Other specific CRS agenda, e.g. global process versus local process, definitions of excluded accounts, application of aggregation rules, monitoring of legislative changes and regular training sessions.
- ▶ Sampling of account documents.

Please note that the above by no means represents any exhaustive list regarding AEOI/CRS compliance.

On the other hand, in the HKIRD's recent enquiry letters which are attached with the standard CRS compliance questionnaire, HKRFIs are very often asked to *"confirm whether an independent reviewer was engaged to periodically review the Financial Institution's internal controls and its compliance with the due diligence and reporting requirements."* In addition, the HKIRD is also keen to understand who the reviewer is, the scope of review and results, and any remediation actions undertaken to address the compliance gaps identified. One should consider that a timely periodic review and the subsequent remediation activities are essential for a robust CRS compliance program. As we observed, as part of the governance and control environment, the HKIRD during their onsite inspection would be keen to look for periodic review being conducted by a competent reviewer and that remediation action plans have been formulated and actively managed.

It is expected that the HKIRD will continue its effort in performing onsite AEOI compliance inspections going forward and therefore each HKRFI should expect that the HKIRD may eventually come in for an onsite audit.

Updates to the CRS

On 8 June 2023, the OECD published the *"International Standards for Automatic Exchange of Information in Tax Matters: Crypto-Asset Reporting Framework and 2023 update to the Common Reporting Standard"*.

There are two parts to this publication:

- ▶ Crypto-Asset Reporting Framework (CARF); and
- ▶ Update to the CRS

CARF is a new information exchange regime introduced by the OECD, covering the reporting of acquisition and disposal of crypto-assets by Reporting Crypto-Asset Service Providers. It is expected that both CARF and the update to the CRS would be implemented by participating jurisdictions locally as early as 1 January 2026 to allow first reporting in 2027.

While we shall provide more details on CARF on another occasion, in relation to the update to the CRS, certain key changes are set out as follows:

	Expansion of the scope of CRS	EY observations
1	Expansion of CRS to new digital asset classes	<ul style="list-style-type: none"> ▶ Expansion of the definition of Financial Assets to include "Relevant Crypto-Assets" ▶ Expansion of the definition of Depository Institutions and Depository Accounts to cover "Central Bank Digital Currencies" and "Specified Electronic Money Products" <p>Depository Institutions, Custodial Institutions and Investment Entities going forward shall cover the above new digital asset classes.</p>
#	Uplifting the legal status of certain CRS due diligence requirements	EY observations
2	Several CRS due diligence requirements previously outlined in the OECD <i>"CRS-related Frequently Asked Questions"</i> will also be formalized into the	<ul style="list-style-type: none"> ▶ This includes the OECD integrating the explanatory guidance for Reporting Financial Institutions aimed at addressing the misuse of certain citizenship and residence by investment (CBI/RBI) schemes within the text of the CRS regulations. Where an Account Holder or Controlling Person has declared tax residency(ies) in a potentially high-risk CBI/RBI scheme, the Reporting Financial Institutions are required to raise additional questions to ascertain the tax residency(ies) of such persons.

	text of the CRS and its commentary themselves, i.e., giving a legal status to the requirements.	
#	Upcoming CRS reporting requirements	EY observations
3	Whether an Account Holder has provided a valid self-certification	► It is currently unclear as to whether this requirement is merely in relation to an Account Holder having a valid self-certification at the time of onboarding, or the Account Holder having a valid self-certification at the time of reporting. System should therefore be ready for both scenarios before further clarity is available from the OECD.
4	Whether the account is a Preexisting Account or a New Account	► It would be blatant to the tax authorities if an account is a New Account but without a valid self-certification combining the new reporting requirement under #3 above. Robust New Account due diligence procedures should be ensured.
5	Whether the account is a joint account, including the number of joint Account Holders	► Robust identification and tagging of joint accounts are required.
6	Types of Financial Accounts	<p>► Financial account definitions are never straightforward when it comes to real life applications on complex financial products and services.</p> <p>► Product and activity analyses become even more important than any time before given the new reportable information of types of Financial Accounts</p>
7	Role(s) of each Controlling Person of a Passive Non-Financial Entity (NFE)	► The reporting of the role of a Controlling Person would soon be changing from "Optional" to "Mandatory". Therefore, HKRFIs should ensure robust process on determination of Controlling Person types.
8	Role(s) of each Equity Interest Holder of an Investment Entity that is a legal arrangement	► HKRFIs that are Investment Entities are required to report the role(s) of each Equity Interest Holder that is a legal arrangement (e.g., limited partnership, trust) if such information is available.

#	Implementation Considerations	EY observations
9	Impact to current processes, channels and systems based on new reporting data points in line with the CRS amendments	<ul style="list-style-type: none"> ► To determine the validity of a customer's self-certification, it is essential to review the current onboarding process, channels and systems. This involves assessing whether the current channels are digitized or rely on offline physical forms. If offline, adoption of existing digital capabilities or a new tool should be considered. Once digitized, appropriate data validation and reasonableness checks should be configured to trigger during data entry or amendment with application of the latest technologies. ► Review of the customer tax data repository for customer, account and reference data gaps. Introduction of fields to capture the timing of validity of self-certification forms, pre-existing or new accounts, sole or joint accounts, types of controlling persons and types of equity interest holders of an Investment Entity that is a legal arrangement. Remediation methods for existing information on record within the repository, either with internal IT support or through outreach. ► Enhancement of the automated extraction process to include new reporting data fields and data validation checks for completeness before moving onto XML generation.

Overall, the new amendments on CRS lead to the needs of substantial changes to the existing due diligence procedures and IT infrastructure upgrade. In particular, without upfront enhancement of the due diligence procedures, the newly required reportable information would not be available. HKRFIs should take prompt action on getting prepared the anticipating CRS new requirements or otherwise they could not catch up with the implementation timeline as early as in the beginning of 2026. We also expect that Hong Kong will unlikely be lagging behind in legislating the new requirements into laws locally.

Amendments to the list of participating jurisdictions

Further to the OECD's recommendation to the Hong Kong Government with respect to the CRS legislative framework, the Hong Kong Government has announced that it will amend the list of CRS participating jurisdictions under the Inland Revenue Ordinance. The purpose of this is to prevent persons from using a professionally managed investment entity which does not actually exchange data with Hong Kong to circumvent CRS reporting. This amendment shall add 11 additional jurisdictions to Hong Kong's participating jurisdictions list and remove 9 jurisdictions without activated exchange relationships with Hong Kong. The amendment is proposed to come into effect from 1 January 2025.

In view of this update, HKRFIs should revisit their population of Account Holders, pertaining the following activities:

- ▶ If HKRFIs have onboarded Investment Entities resident in the 9 jurisdictions to be removed from the list of participating jurisdictions, HKRFIs should identify the relevant Controlling Persons of the deemed Passive Non-Financial Entities;
- ▶ If HKRFIs have onboarded Investment Entities located in any of the 11 newly added participating jurisdictions and are managed by another Financial Institution, HKRFIs should also reassess the CRS classifications, and apply additional due diligence procedures where necessary.

Looking ahead

In 2023, it has been reported that at least EUR 1.8 billion additional revenue in Asia were identified following the implementation and use of the tax transparency standards. 12 Asian members had also reported on their use of CRS data to support ongoing tax activities, such as risk assessment, tax audit, tax collection, pre-filling of tax returns or notification of taxpayers.¹

In this era of AEOI implementation effectiveness with the heightened scrutiny from the HKIRD and the upcoming CRS amendments, HKRFIs should take this great opportunity to capitalize its AEOI compliance capability and operational efficiencies through thorough compliance review, system enhancement and technological advancement.

Talk to us - EY CTORS Team based in Hong Kong for your upcoming plan on AEOI compliance and operational efficiencies.

¹ Tax Transparency in Asia 2024: Asia Initiative Progress Report, Global Forum on Transparency and Exchange of Information for Tax Purposes

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