Recent developments in AEOI and implications for non-traditional financial institutions

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In brief

The Hong Kong Inland Revenue Department (IRD) has intensified Automatic Exchange of Financial Account Information (AEOI) compliance checks, issuing enquiry letters to non-traditional financial institutions (FIs), such as trust or company service provider (TCSP) licensees and private investment companies, and registered FIs with nil reports.

Failure to comply with the enquiry letters may result in fines and penalties. Entities should assess their AEOI obligations (including exemptions), maintain a robust compliance framework, and promptly address the IRD's requests to ensure regulatory compliance.

This news flash provides a summary of the recent developments and their implications. For a detailed discussion, please contact our CRS/FATCA team based in Hong Kong.

In detail

Background

The Common Reporting Standard (CRS), a global framework for the AEOI, has been effective in Hong Kong since 1 January 2017.

Under AEOI, FIs (as defined under the rules) are required to implement due diligence procedures to identify reportable accounts. These accounts are defined as financial accounts held by individuals, entities, or their controlling persons who are tax residents of reportable jurisdictions. FIs must collect and maintain specified information for these accounts and report it annually to the IRD, which subsequently exchanges the information with the tax authorities of the relevant reportable jurisdictions. Non-compliance with the AEOI obligations can result in penalties.

Recent development

The IRD has recently intensified its review of the AEOI compliance status of FIs in Hong Kong. Apart from focusing on traditional FIs (e.g. banks, insurance companies and fund managers), the IRD has in recent months also issued thousands of enquiry letters to non-traditional FIs, including TCSP licensees, private investment companies, and others. Notably, even entities filing nil report under the AEOI are receiving these letters which mandate the provision of specific information within a stipulated timeframe.

Enquiry letters to TCSP licensees

The IRD requires TCSP licensees to provide:

- disclosure of principal activities with supporting documents;
- a self-assessment confirming whether the recipient is an FI. If yes, clarification on whether it maintains any reportable accounts and the reason for not registering an AEOI Account; and
- details of trusts for which the recipient acts as trustee, including the AEOI classification and reporting status of these trusts.

Enquiry letters to private investment companies and other non-traditional FIs

For private investment companies and other types of non-traditional FIs, the IRD requests:
- confirmation of whether an AEOI account has been registered;
- a statement clarifying whether the entity is an FI and, if so, specifying the type of FI;
- if the entity is an FI, reason(s) for not registering an AEOI account; and
- if the entity is not an FI, a justification for this determination.

Enquiry letters to registered FIs with nil reporting

For FIs that have reported no reportable accounts, the IRD seeks:
- details of the due diligence procedures established by the FI, including their review history;
- disclosure of principal activities with supporting documents;
- an explanation for submitting nil report; and
- information and samples of financial accounts maintained by the FI.

Penalties for non-compliance

Failure to respond adequately to an enquiry letter may result in a fine of HK$10,000. Additionally, the Inland Revenue Ordinance (IRO) also provides sanctions against FIs, service providers and other relevant parties for offences related to AEOI compliance. These punitive measures address non-compliance, submission of incorrect returns, and defrauding with intent, as outlined in sections 80B to 80F of the IRO. Penalties can be generally categorised as follows:

- Non-compliance: a fine at Level 3 (HK$10,000)
- Submission of incorrect returns: a fine at Level 3 (HK$10,000)
- Defrauding with intent: a fine at Level 3 (HK$10,000) or Level 5 (HK$50,000), with imprisonment for six months or three years, depending on the severity of the offence

Our observations

The recent wave of enquiry letters issued by the IRD underscores that the scope of AEOI review extends beyond traditional FIs to include non-traditional FIs such as TCSP licensees and private investment companies. This development emphasises the importance for non-traditional FIs to carefully review and reassess their obligations under the AEOI framework. For those determined to be subject to AEOI requirements, proactive steps should be taken to ensure compliance and avoid penalties. These steps include:

- assessing whether any exemptions apply to financial accounts or reportable accounts that may waive reporting obligations;
- establishing and implementing robust compliance programmes to identify and report relevant accounts;
- registering for an AEOI account with the IRD; and
- notifying the IRD within three months of commencing to maintain reportable accounts.

Trust-specific considerations

From a trust perspective, entities such as trusts and their trustees may be classified as FIs or hold reportable accounts under AEOI, leading to potential disclosure of trust-related information to tax authorities. For instance, trusts classified as FIs (e.g. professionally managed trusts) must comply with AEOI due diligence and reporting obligations, which may include disclosing details about settlors, beneficiaries, or controlling persons who are tax residents of reportable jurisdictions. Even trusts that are not FIs may have their financial accounts reported by other FIs, such as banks, if they hold reportable accounts. Trustees and TCSPs should ensure proper AEOI compliance by accurately determining the trust's classification, identifying reportable accounts, and maintaining robust documentation.

Assessing AEOI obligations for trusts can be complex and is often not straightforward, as each trust may have unique features, such as varying structures, trust arrangements, or asset types. These differences complicate the determination of whether a trust qualifies as an FI, holds reportable accounts, or is eligible for exemptions. Given this complexity, trustees or the stakeholders of the trusts are strongly encouraged to seek professional advice in this aspect.

Registered FIs with nil reportable accounts should conduct a comprehensive review of their AEOI compliance programmes to identify and rectify any potential deficiencies. Ensuring that policies, procedures, and controls are up-to-date, robust and fully aligned with the latest regulatory requirements is vital to satisfying the IRD's requirements and mitigating the risk of enforcement actions.

The takeaway

Non-traditional FIs, such as TCSP licensees and private investment companies, should promptly assess their AEOI obligations, including whether any exemptions apply to financial accounts or reportable accounts that may waive reporting requirements. Similarly, registered FIs with nil reporting should revisit their position of financial accounts. Clients of non-traditional FIs, such as those with trusts, should be mindful that their information may be disclosed and exchanged by the IRD with the tax authorities of the relevant reportable jurisdictions by their service providers. As such, both service providers (FIs and non-FIs) and their clients are advised to seek professional advice to ensure the accuracy of what is reported and to maintain robust compliance with AEOI requirements.

In the coming weeks, we will host a webinar to provide you with a comprehensive overview of this matter. We are also pleased to offer our assistance including:

- responding to enquiries from regulatory authorities;
- conducting AEOI legal entity analysis and compliance health check;
- drafting and reviewing AEOI policies and frameworks;
- supporting AEOI registration and annual AEOI reporting; and
- providing ad-hoc advisory support.

Let's talk

For a deeper discussion of how this impacts your business, please contact:

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