

CHAPTER 8

DUE DILIGENCE: GENERAL REQUIREMENT

The due diligence procedures that reporting financial institutions must follow are prescribed in Schedule 17D of the IRO. There are different due diligence procedures for financial accounts held by individuals and entities as well as for pre-existing and new accounts.

2. A financial account held by an individual as a partner of a partnership is to be treated as an entity account and is not to be treated as an individual account. On the other hand, if a financial account is held by an individual as a sole-proprietor of a business, the account is to be treated as an individual account.

3. The legislation for AEOI authorises financial institutions to identify, maintain and report information on the tax residence of account holders, irrespective of whether or not they are tax resident in a reportable jurisdiction. This referred to as the “wider approach”. Financial institutions are required to carry out due diligence procedures on financial accounts that they hold in order to establish if the person holding the account is tax resident of a reportable jurisdiction.

4. If an account holder is identified as being tax resident in any of the reportable jurisdictions then he is a reportable person and the account is a reportable account.

5. An account is treated as a reportable account as of the date it is identified as such pursuant to the due diligence procedures that financial institutions must follow.

The wider approach

6. The “wider approach” enables reporting financial institutions to capture and maintain information on the tax residence of account holders irrespective of whether or not that account holder is a reportable person for any given reportable period.

7. The due diligence procedures are designed to identify accounts which are held by the residents of the reportable jurisdictions. However, the number of these jurisdictions is not fixed and more jurisdictions may be added to the list of reportable jurisdictions over time. As a result, the legislation for AEOI has been designed to authorise a wider approach to recording the territory in which a person is tax resident irrespective of whether that territory is a reportable jurisdiction at the time when the due diligence procedures are performed. The wider approach also authorises the collection of TIN and date of birth from account holders irrespective of whether or not that account holder is a reportable person for any given reportable period.

8. Reporting financial institutions are authorised to identify the territory in which an account holder or a controlling person is resident for income tax or corporation tax purposes, or for the purposes of any other tax of a similar character that has been imposed by that territory. This effectively enables the financial institutions to “future proof” their processes such that when a new jurisdiction is added to the list of reportable jurisdictions the work in identifying where existing customers are resident has already been carried out. Reducing the number of times that due diligence processes have to be carried out should result in lower costs for the financial institutions in complying with their obligations. Financial institutions will only need to revisit the determination of tax residence in those cases where there has been a change of circumstance.

9. The following examples illustrating the application of due diligence under the wider approach:

(a) Example 1: New accounts

Mr. X is a tax resident of Jurisdiction F and opens an account with Bank-HK on 1 March 2017 (i.e. a new account). At the time of account opening, Jurisdiction F is not a reportable jurisdiction.

Under the wider approach, Bank-HK will need to collect a self-certification from Mr. X, which will include his jurisdiction of residence for tax purposes, TIN and date of birth at the account opening stage, irrespective of whether Jurisdiction F is a reportable jurisdiction.

If subsequently Jurisdiction F becomes a reportable jurisdiction which takes effect from 2019, Bank-HK can rely on the self-certification to establish that the account is a reportable account and will then need to report Mr. X’s 2018 financial account information to the IRD in 2019.

(b) Example 2: Pre-existing accounts

Mr. Y is a tax resident of Jurisdiction F and opened an account with Bank-HK in 2014 (i.e. a pre-existing account). Jurisdiction F becomes a reportable jurisdiction as from 2019.

Under the wider approach, Bank-HK will need to conduct an indicia search of all pre-existing accounts to identify accounts held by residents of any other territories outside Hong Kong in 2017. In 2018, Bank-HK may rely on the results of the 2017 exercise to determine whether Mr. Y’s account is a reportable account.

Bank-HK would be required to collect Mr. Y's TIN and date of birth by the end of 2020 (the second calendar year following the year in which the account is identified as a reportable account).

Reportable accounts

10. An account is treated as a reportable account from the date it is identified as such pursuant to the due diligence procedures that the reporting financial institution is required to follow. Generally, information must be reported annually to the IRD on that account in the calendar year following the year to which the reportable information relates.

11. Once an account has been identified as a reportable account it remains so until there is a change that takes the account out of the definition of reportable account. This can happen in a number of ways:

- (a) the account holder ceases to be a reportable person.
- (b) the account is closed or transferred to another financial institution in its entirety (where it may become a reportable account by that business).
- (c) the account becomes an excluded account.
- (d) the reporting financial institution becomes a non-reporting financial institution.

12. While the account remains a reportable account it must be reported even where the balance or value of the account is zero or negative. It also remains reportable where nothing has been credited to or in respect of the account during the appropriate reportable period.

13. When an account ceases to be a reportable account it no longer needs to be reported, but where the account is closed information with respect to that account must be reported until the date of closure.

14. The following examples illustrate the circumstances where an account becomes or ceases to be a reportable account:

- (a) **Account becomes reportable** – a reporting financial institution carries out due diligence procedures on low value pre-existing individual accounts as at 31 December 2016 between 1 January 2017 and 31 December 2018. On 22 March 2018 the financial institution identifies

an account that belongs to an individual resident in Jurisdiction F (a reportable jurisdiction). The account is a reportable account from that date. Information on that account is reportable for the full calendar year 2018, the first report being made in 2019 and annually thereafter.

- (b) **Account reportable after change of circumstance** – a new account is opened by an individual on 20 June 2017. The self-certification provided by the individual on opening the account shows that the individual is not a tax resident of any reportable jurisdiction. The account is thus not a reportable account. On 13 September 2019 the individual notifies the reporting financial institution of his move to Jurisdiction F to work and provides the financial institution with a residential address in Jurisdiction F. This provides an indicium of tax residence in Jurisdiction F which is a change of circumstances. The account becomes a reportable account from that and is reportable for the full calendar year 2019, the first report being made in 2020 and annually thereafter.
- (c) **Account ceases to be reportable** – the account holder of the account in (a) above notifies the reporting financial institution that he has moved permanently to Hong Kong and is no longer a tax resident of Jurisdiction F with effect from 17 April 2020. As a result, the individual ceases to be a reportable person. As the account ceases to be a reportable account in the calendar year 2020 no report from the reporting financial institution is required in 2021 or any subsequent calendar year unless the account becomes reportable once again.
- (d) **Account is closed** – a reportable account is closed by the account holder on 14 August 2018. The reporting financial institution must report in 2019 that the account has been closed along with information in respect of that account for the period from 1 January 2018 to the date of closure. The amount of information will depend on the regime under which reporting occurs.
- (e) **Account ceases to be reportable and is then closed** – the account holder in (c) above closes the account with the reporting financial institution on 11 October 2020. As the closure occurred after the account ceased to be reportable, information with respect to the closure of the account is not required to be reported in 2021.

Balance or value of account

15. The balance or value of a reportable account is part of the reportable information that is to be automatically exchanged. It is also relevant for other purposes such as the due diligence procedures for pre-existing entity accounts and the account aggregation rules.

16. The balance or value of the reportable account is to be determined as of the last day of the calendar year or other appropriate reporting period. If the balance or value of the account requires conversion from one currency to another the Guidance at Chapter 14 on rules of account aggregation and currency should be considered.

17. If the balance or value of the account is negative it should be reported as a zero balance or value.

Date for determining the balance or value for thresholds

18. Thresholds apply to pre-existing individual and entity accounts. For due diligence purposes, it is necessary to determine whether the aggregate value of accounts held by an individual exceeds an amount equivalent to \$7.8 million or the value of accounts held by an entity exceeds \$1.95 million.

19. The thresholds are applied on the last day of a calendar year. If a reporting financial institution has elected to report on other appropriate reporting period instead of the calendar year, the balance or value on the account that is to be used for determining if the threshold has been exceeded is that on the last day of the appropriate reporting period ending in that year.

20. Where a reporting financial institution values financial accounts at regular points during the year, the balance or value on the last such valuation in the calendar year or appropriate reporting period may be used for determining if the aggregate value has exceeded the thresholds.

Reliance on service providers

21. Reporting financial institutions may use third party service providers to fulfil some or all of their due diligence obligations but the obligations remain the responsibility of the financial institution. Any failure by a third party service provider would be regarded as a failure by the financial institution.

22. For example, where a financial adviser has the customer relationship for introducing business to a reporting financial institution, such as cash value insurance

contracts, the financial adviser is often best placed to obtain the self-certification needed to carry out the due diligence process on the new account. The reporting financial institution may rely on the financial adviser to obtain the self-certifications on its behalf.

23. Similarly, when a reporting financial institution engages a third party to run AML/KYC processes it may rely on the report provided on the basis that the third party has relied on appropriate documentary evidence in producing the report. In such a case the reporting financial institution may not hold the original documents or certified copies of them. If the IRD requires sight of documents in these circumstances, photocopies will be acceptable subject to the reporting financial institution being able to obtain originals or certified copies should that be necessary.

Alternative procedures for pre-existing accounts

24. Reporting financial institutions may apply:

- (a) the due diligence procedures for new accounts to pre-existing accounts, and/or
- (b) the due diligence procedures for high value accounts to low value accounts.

25. Where a reporting financial institution chooses to apply one or both of these alternatives it may do so with respect to all its pre-existing accounts or, separately, to any clearly identified group of such accounts. A group of accounts may, for example, be those maintained by a particular line of business or those maintained in a particular location.

26. Where a reporting financial institution chooses to apply the new account procedures to pre-existing accounts the rules that otherwise apply to pre-existing accounts continue to apply. For example, the reporting financial institution can still rely on the exception for reporting a TIN or date of birth if it is not in its records and is not otherwise required to be collected by domestic law. However, the reporting financial institution is required to use reasonable efforts to obtain the TIN and date of birth by the end of the second calendar year following the year in which the account is identified as a reportable account.

New accounts treated as pre-existing accounts

27. The classification of a financial account as “pre-existing account” or “new account” is generally dependent on the account opening date. New account means a

financial account opened and maintained by a reporting financial institution on or after 1 January 2017. For accounts opened prior to this date, they are classified as pre-existing accounts. Subject to meeting certain conditions, a reporting financial institution may treat certain new accounts held by pre-existing customers as pre-existing accounts for due diligence purposes, i.e. relying on paragraph (b) of the definition of pre-existing account in section 50A of the IRO (the expanded definition).

28. A customer is treated as pre-existing if it holds a financial account with a reporting financial institution or its related entity. Thus, if a pre-existing customer opens a new account, the reporting financial institution may rely on the due diligence procedures it (or its related entity) applied to the customer's pre-existing account to determine whether the account is a reportable account.

29. For a "new account" (subsequent account) to be treated as a pre-existing account, the following conditions have to be met:

- (a) the account holder also holds with the reporting financial institution, or its related entity within Hong Kong, a financial account that is a pre-existing account (old financial account);
- (b) the reporting financial institution (and, as applicable, its related entity within Hong Kong) treats both accounts, and any other subsequent accounts of the account holder that are treated as pre-existing accounts, as a single account for the purposes of satisfying knowledge requirement and determining the balance or value of any of the financial accounts when applying any account thresholds;
- (c) the subsequent account is subject to AML/KYC procedures and the institution is permitted to carry out such AML/KYC procedures for the subsequent account by relying on the AML/KYC procedures carried out for the old financial account; and
- (d) the opening of the subsequent account does not require the provision of new, additional, or amended customer information by the account holder other than for the purpose of complying with sections 50B, 50C, 50F and 50G of the IRO.

30. The expanded definition of pre-existing account may also be relied on by fund managers to treat certain new equity or debt interests held by existing customers as pre-existing accounts for due diligence purposes. A fund is a related entity of another fund if the two entities are investment entities as described in paragraph (e)



of the definition of investment entity and (a) the entities are under common management; and (b) the management fulfills the due diligence requirements for the entities under schedule 17D of the IRO.