



CHAPTER 18 MISCELLANEOUS

Related entity

An entity is regarded as being related to another entity if –

- (a) one entity controls the other or the two entities are under common control (“the Related Entity Group”). For this purpose, control is taken as including the direct or indirect ownership of more than 50 per cent of the voting rights and value of the shares in an entity; or
- (b) the two entities are investment entities as described in paragraph (e) of the definition of investment entity and:
 - (i) the entities are under common management; and
 - (ii) the management fulfills the due diligence requirements for the entities under Schedule 17D to the IRO.

2. Whether an entity is a related entity to another entity is relevant for the account balance aggregation rules, for applying the definition of pre-existing account and for determining if an NFE can meet the criteria for being an active NFE.

Investment entities

3. Investment entities which have received seed capital from a member of a group to which the investment entity belongs is not considered a related entity.

4. In general a seed capital investment is an initial capital contribution (that is intended as a temporary investment), made to an investment entity. This is generally for the purposes of establishing a performance record before selling interests in the entity to unrelated investors, or for purposes otherwise deemed appropriate by the manager.

5. Specifically, an investment entity is not considered a related entity as a result of a contribution of seed capital by a member of the group if:

- (a) the member of the group that provides the seed capital is in the business of providing seed capital to investment entities that it intends to sell to unrelated investors;
- (b) the investment entity is created in the course of its business;



- (c) any equity interest in excess of 50% of the total value of stock of the investment entity is intended to be held for no more than three years from the date of acquisition; and
- (d) in the case of an equity interest that has been held for over 3 years, its value is less than 50% of the total value of the stock of the investment entity.

Passive income

6. In determining whether or not an NFE is an active NFE (see paragraph 10 below) or a passive NFE it is necessary to consider the nature of the income that the entity receives as it is one of the requirements that less than 50% of the gross income of an NFE can be passive income for the entity to be regarded as an active NFE.

7. As the term suggests, passive income is derived from investing in assets rather than from activities carried on in the normal course of a trade or business. Passive income includes the portion of income that consists of:

- (a) dividends and other distributions of income;
- (b) interest;
- (c) income equivalent to interest;
- (d) rents and royalties, other than rents and royalties derived in the active conduct of a trade or business conducted, at least in part, by employees of the NFE;
- (e) annuities;
- (f) the excess of gains over losses from the sale or exchange of property that gives rise to passive income described previously;
- (g) the excess of gains over losses from transactions (including futures, forwards, options and similar transactions) in any financial assets;
- (h) the excess of foreign currency gains over foreign currency losses;
- (i) net income from swaps;
- (j) amounts received under cash value insurance contracts.

8. The context in which the income described above is received is important. For



example, where the NFE is a dealer in financial assets any such income as described above may be income from a trading activity. Where the income described above is received by an NFE and is accounted for, or is taxable as, income from trading activities it should not be included in gross income as passive income.

Non-financial entity (NFE)

9. An NFE is any entity that is not a financial institution. NFEs are then divided into two categories: active NFEs and passive NFEs. The passive NFE category is effectively a default category, any NFE that does not meet the criteria to be an active NFE is a passive NFE.

10. An NFE can be an active NFE if it meets any of the following criteria:

- (a) it is active by reason of income and assets. This requires less than 50% of its gross income for the preceding calendar year or other appropriate reporting period to be passive income and less than 50% of its assets held in the same period to be assets that produce or are held for the production of passive income;
- (b) its stock is regularly traded on an established securities market or it is a related entity of such an entity;
- (c) it is a governmental entity, international organization, central bank or a wholly owned subsidiary of such an entity;
- (d) it is a holding company for NFEs that are members of a non-financial group. It does not qualify as an active NFE where these holdings are part of a business as an investment fund or vehicle whose purpose is to acquire or fund companies and then hold interests as capital assets for investment purposes;
- (e) it is a start-up NFE which is not yet operating a business and has no prior operating history, but is investing capital into assets with the intention of operating a business other than that of a financial institution. This category only applies during the first 24 months after the date that the NFE was first formed;
- (f) it is an NFE that has not been a financial institution in the last 5 years and which is in the process of liquidating its assets or is reorganizing with a view to continuing or recommencing business operations other than as a financial institution;
- (g) it is a treasury centre of a non-financial group engaging in financing and hedging transactions with or for related entities;



- (h) it is a not-for-profit organization set up for religious, charitable, scientific, artistic, cultural, athletic or educational purposes; or it is established and operated as a professional organization, business league, chamber of commerce, labour organization, agricultural or horticultural organization, civic league or an organization operated for the promotion of social welfare. In all cases the organization must be exempt from income tax and its income and assets cannot be applied other than for the express purposes for which the organization is established.

Documentary evidence

11. There are a number of instances where a reporting financial institution is required to review or obtain documentary evidence in determining whether or not an account holder is a reportable person.

12. A reporting financial institution (or the third party service provider acting on behalf of the financial institution) can accept documentary evidence to support an account holder's status provided the documentation (in original or certified copy form) meets any of the following criteria:

- (a) a Certificate of Residence issued by an appropriate tax official of the jurisdiction in which the account holder claims to be resident, for example, a Certificate of Resident Status in relation to a person's Hong Kong tax residence issued by the IRD;
- (b) any valid identification issued by an authorized government body (for example, a government or agency thereof, or a municipality), that includes the individual's name and is typically used for identification purposes, for example, a passport or driving licence;
- (c) with respect to an entity, documentation issued by an authorized government body that includes the name of the entity and either the address of its principal office in the jurisdiction in which it claims to be resident or the jurisdiction in which the entity was incorporated or organized;
- (d) any audited financial statement, third party credit report, bankruptcy filing, or securities regulator's report.

13. Examples of valid documentary evidence include the following:

- (a) for natural persons: passport, identity card or driving licence;
- (b) for corporations: a copy of the Certificate of Incorporation, the



Memorandum and Articles of Association or Business Registration Certificate;

- (c) for partnerships: a copy of the partnership agreement or Business Registration Certificate;
- (d) for trusts: either a copy of the trust deed and any subsidiary deed evidencing the appointment and powers of trustees, or certified copies of extracts from the deeds.

Validity of Documentation

14. Documentary evidence, including a self-certification, used to establish an account holder's status remains valid indefinitely subject to a change in circumstance which results in a change of the account holder's status. When reviewing documentary evidence, a financial institution is expected to give preference to more recent documents, or those with more specific information, than another document.

Retention of documents

15. A reporting financial institution or a third party undertaking due diligence procedures for a financial institution must retain records of the documentary evidence, or a notation or record of the documents reviewed and used to support an account holder's status for a period of 6 years beginning on the date on which the procedures are completed.

16. The documentary evidence can be retained as originals, photocopies or in an electronic format.

17. A reporting financial institution that is not required to retain copies of documentation reviewed under AML due diligence procedures is treated as having retained a record of such documentation if it retains a record in its files noting:

- (a) the date the documentation was reviewed;
- (b) each type of document;
- (c) the document's identification number where present (for example, a passport number); and
- (d) whether any indicia of residence in a reportable jurisdiction were identified.

18. For high value pre-existing accounts where a relationship manager enquiry is required, records of electronic searches, requests made and responses to relationship



manager enquiries should also be retained for 6 years beginning on the date on which the procedures are completed.

Document Sharing

19. Documentation is required to support the status of each financial account held. However in the following circumstances documentation obtained by a reporting financial institution can be used in relation to more than one financial account.

Single Branch System

20. A reporting financial institution may rely on documentation furnished by a customer where an existing customer opens a new financial account with the same financial institution and where both accounts are treated as a single account or obligation for due diligence and reporting purposes.

Universal account systems

21. A reporting financial institution may rely on documentation furnished by a customer for an account held at another location of the same financial institution or at a location of a related entity of the financial institution if the financial institution treats all accounts that share documentation as a single account for due diligence and reporting purposes, and the financial institution and the other location or related entity are part of a universal account system that uses a customer identifier that can be used to retrieve systematically all other accounts of the customer.

22. In this scenario a reporting financial institution must be able to produce to the IRD the necessary records and documentation relevant to the status claimed (or a notation of the documentary evidence reviewed, if the financial institution is not required to retain copies of the documentary evidence for AML purposes).

Shared account systems

23. A reporting financial institution may rely on documentation provided by a customer for an account held at another location of the same financial institution, or at a location of a member of the Related Entity Group of the financial institution, if:

- (a) the financial institution treats all accounts that share documentation as consolidated accounts; and
- (b) the financial institution and the other location or the Related Entity Group member share an information system, electronic or otherwise, that is described below.

24. A shared account system must allow the reporting financial institution to easily



access data about the nature of the documentation, the information contained in the documentation (including a copy of the documentation itself), and the validity status of the documentation.

25. If the reporting financial institution becomes aware of any fact that may affect the reliability of the documentation, the information system must allow the financial institution to easily record this data in the system.

26. Additionally the financial institution must be able to show how and when it transmitted data regarding such facts into the information system and demonstrate that any data it has transmitted to the information system has been processed and the validity of the documentation subjected to appropriate due diligence.

27. A reporting financial institution that opts to rely upon the status designated for the account holder in the shared account system, without obtaining and reviewing copies of the documentation supporting the status, must be able to produce upon request by the IRD all documentation (or a notation of the documentary evidence reviewed, if the financial institution is not required to retain copies of the documentary evidence for AML purposes) relevant to the status claimed.

Mergers and bulk acquisitions

28. Where a reporting financial institution acquires accounts by way of a merger or bulk acquisition, the reporting financial institution can rely on the status of account holders as determined by the predecessor financial institution, provided that the predecessor financial institution had met its due diligence obligations.

29. The reporting financial institution may continue to rely on the status of the account holder as long as it has no reasonable cause to believe that the status is unreliable or incorrect.

30. The IRD would expect that the reporting financial institution undertake a sample review of the acquired accounts to determine that the account holders' status, assigned by the predecessor financial institution, is reliable. An account holder's status needs to be verified by the acquiring financial institution in accordance with the due diligence procedures should the acquirer have reason to know that it is incorrect or if there is a change in circumstances.

31. The reporting financial institution may treat accounts acquired in a merger or bulk acquisition that takes place after 31 December 2016 as pre-existing accounts for the purposes of applying the identification and documentation procedures.

Merger of investment entities

32. Mergers of investment entities can be different to mergers of custodial



institutions or depository institutions. The financial accounts of investment entities are its equity and debt interest, so the merger of two such entities creates a series of new accounts in the surviving entity.

33. Mergers of investment entities normally involve a surviving fund taking over the assets of the merging fund in exchange for issuing shares or units to the investors of the merging fund. The shares or units in the merging fund are then extinguished. The new shares in the surviving fund are new accounts except where both funds were previously administered by the same person, for example the fund manager, who reported on behalf of the investment entities or the merged fund takes over and holds the information on the reportable status of the debt and equity holders in the merged fund and can, therefore, continue to report on the basis of that information.

Controlling persons

34. Sections 50A(1) and (6) of the IRO contain the definition of controlling persons and requirements to identify them. A controlling person, in relation to an entity, means an individual who exercises control over the entity.

35. For an entity that is a corporation or partnership, a reporting financial institution must identify:

- (a) any individual who ultimately has a controlling ownership interest (i.e. more than 25% (if an entity is a corporation) or 0% (if an entity is a partnership) of the capital or profits) in the entity;
- (b) any individual exercising control (i.e. more than 25% (if an entity is a corporation) or 0% (if an entity is a partnership) of the voting rights) over the entity; and
- (c) any individual exercising ultimate control over the management of the entity.

Where no individual is identified as exercising control of the entity, the reporting financial institution must identify the individual who holds the position of senior managing official of the entity.

36. For an entity that is a trust, the term “controlling person” is explicitly defined to mean the settlor, trustee, protector (if any), enforcer (if any), beneficiary or a member of a class of beneficiaries, of the trust and any individual who has ultimate effective control over the entity. If the settlor, trustee, protector, enforcer, or the beneficiary or the member of the class of beneficiaries, of the trust is another entity, the reporting financial institution must identify the controlling persons of such entity. The settlor, trustee, protector, enforcer, or the beneficiary or the member of the class of beneficiaries must always be treated as controlling persons of a trust, regardless of whether or not



any of them exercises control over the trust.

37. For an entity that is equivalent or similar to a trust (covering legal person and legal arrangement), a reporting financial institution must identify any individual in equivalent or similar positions to a controlling person of a trust as stated above.

38. The term “Controlling Persons” corresponds to the term “beneficial owner” as described in Recommendation 10 and the Interpretative Note on Recommendation 10 of the FATF Recommendations (as adopted in February 2012), and must be interpreted in a manner consistent with the FATF Recommendations.