CHAPTER 17
TREATMENT OF TRUSTS

The due diligence and reporting obligations for AEOI will generally apply to trusts in two circumstances: (a) when a trust is a reporting financial institution, and (b) when a trust is an NFE that maintains a financial account with a reporting financial institution.

2. This Chapter outlines the basic features of a trust which are relevant to AEOI. It then describes the application of the steps discussed in Chapter 1 to a trust that is a reporting financial institution, in which case the trust will report about the financial accounts held in the trust. This Chapter then describes the application of the steps discussed in Chapter 1 by a reporting financial institution to a trust that is an NFE account holder, in which case the reporting financial institution may have reporting obligations regarding the account held by the trust and its controlling persons. This Guidance may also apply to other similar legal arrangements, to the extent the application of such Guidance is appropriate.

Basic features of a trust

3. In general terms, a trust is a fiduciary relationship, rather than an entity with its own separate legal personality. The trust arrangement commences when a person (the settlor, or also called the grantor) transfers specific property to the trustee, with the intention that it be applied for the benefit of others (the beneficiaries). A settlor may place any kind of transferrable property into a trust.

4. A trustee holds the legal title to the trust property and has a duty to administer and deal with the trust property in the interests of the beneficiaries. The terms on which the trustee must act for the beneficiaries are determined by the settlor. These terms may be recorded in a written document (the trust deed), or may be given orally. The terms may be very specific, or leave broad discretion to the trustee.

5. The parties to a trust must include a settlor, a trustee and at least one beneficiary, and there may be more than one of each. These parties may be natural persons or entities.

6. Depending on the nature of the settlor’s continuing interest in a trust, the trust may be revocable or irrevocable. A trust is irrevocable where the settlor has disposed of all of its interest in the trust property. For example, where the settlor no longer has any right to revoke the trust, vary the terms of the trust, or to have the trust

property revert to the settlor. A trust is revocable where the settlor has retained some interest or rights over the trust, such as the right to revoke the trust or to have all or a portion of the trust property return to the settlor. The domestic law in each jurisdiction may further define a revocable and irrevocable trust.

7. The beneficiaries may be named individually or for members of a described group of people (a class of beneficiaries). An example of a class of beneficiaries is "the grandchildren of A". Describing the beneficiaries as a class will not make the trust invalid provided that at some point members of the class will be able to be specifically identified.

8. A beneficiary may have a right to receive mandatory distributions, or may receive discretionary distributions. In general terms, a mandatory beneficiary has an entitlement to a set amount of property at a set time (e.g. "B will receive $50,000 each year"). If the trustee refused to make the distribution, a mandatory beneficiary could enforce their right against the trustee and obtain the property.

9. A discretionary beneficiary does not have an enforceable right to a certain amount of property at any set time. Rather, a discretionary beneficiary is dependent on the trustee to exercise its discretion in the beneficiary's favour. For example, "C will receive a distribution of property from the trust if and when the trustee sees fit." If the trustee refused to make a distribution, a discretionary beneficiary could only sue the trustee to consider exercising its discretion in the beneficiary's favour. For purposes of AEOI, a contingent beneficiary is treated like a discretionary beneficiary. A contingent beneficiary does not have an enforceable right to trust property until a certain event or set of circumstances occurs.

10. A protector may also be appointed in connection with a trust. This is not a compulsory requirement of a trust, but may be included in some jurisdictions. A protector enforces and monitors the trustee's actions, such as overseeing investment decisions or authorizing a payment to a beneficiary.

Determining whether the trust is a reporting financial institution or a NFE

11. As a trust is considered to be an entity for the purpose of AEOI, it may be a financial institution or an NFE. The most likely scenario in which a trust will be a financial institution is if it falls within the definition of investment entity as described in paragraph (e) of the definition of investment entity. This is the case when a trust has gross income primarily attributable to investing, reinvesting, or trading in financial assets and is managed by another entity that is a financial institution. This would also include trusts that are collective investment schemes or other similar

investment vehicle established with an investment strategy of investing, reinvesting, or trading in financial assets.

12. If a trust is not a financial institution, it will be an NFE. NFEs are either active NFEs or passive NFEs depending on their activities. It is possible, although perhaps less common in practice, that a trust could qualify as an active NFE, such as a trust that is a charity or a trading trust carrying on an active business.

13. If a trust is not an active NFE, it will be a passive NFE. In addition, if a trust is holding a financial account with a reporting financial institution, such reporting financial institution must treat the trust as a passive NFE if it is an investment entity described in paragraph (e) of the definition of investment entity that is not resident or located in a participating jurisdiction (i.e. a jurisdiction with which an agreement is in place pursuant to which it will provide financial account information to Hong Kong and which is identified in Part 2 of Schedule 17E of the IRO).

The treatment of a trust that is a reporting financial institution

14. The five steps of identification and reporting of reportable accounts maintained by reporting financial institutions are relevant to a trust: (a) reporting financial institutions (b) review their financial accounts (c) to identify their reportable accounts (d) by applying the due diligence rules and (e) then report the relevant information.

Determining if the trust is a reporting financial institution

15. A trust that is a financial institution will be a reporting financial institution if it is resident in Hong Kong and does not qualify as a non-reporting financial institution. A trust may be a non-reporting financial institution such as a mandatory provident fund scheme or an occupational retirement scheme. A trust could also be a non-reporting financial institution where the trustee itself is a reporting financial institution, and that trustee undertakes all information reporting in respect of all reportable accounts of the trust (and all such reports are exchanged with the relevant jurisdictions concerned).

16. A trust is resident in Hong Kong if it is constituted under the laws of Hong Kong, or if constituted outside Hong Kong, it is normally managed or controlled in Hong Kong. A trust will also be considered to be resident where the trustee(s) is resident. If there is more than one trustee, the trust will be a reporting financial institution in all participating jurisdictions in which a trustee is resident. In other words, if the trustees are each resident in different jurisdictions, the trust would be a reporting financial institution in each of those participating jurisdictions, and would each separately report in respect of their reportable accounts.

17. As explained above, if a trustee of a trust is resident in Hong Kong, the trust would be a reporting financial institution in Hong Kong. However, where the trust is also considered to be resident for tax purposes in another jurisdiction with which Hong Kong automatically exchanges financial account information, and the trust reports all the information required to be reported with respect to reportable accounts maintained by the trust to that jurisdiction, that will relieve the trust from reporting in Hong Kong. In order to obtain such relief, each trustee should be able to demonstrate that all necessary reporting by the trust is actually taking place.

Identifying the financial accounts of a trust that is a reporting financial institution

18. Where a trust is a reporting financial institution, it must identify its financial accounts. If the trust is an investment entity, its financial accounts are defined as the debt and equity interests in the entity.

19. Debt interest is not defined for the purpose of AEOI, and therefore what is considered a debt interest will be determined under the domestic law of Hong Kong. In general, a debt interest is any interest created when a lender lends money to a borrower. For the purpose of paragraphs (c) and (d) of the definition of financial account, any loan by a lender to a financial institution will create a debt interest in the financial institution. The debt interest can arise through, for example, a simple loan, a bond issue or note issue.

20. The equity interests are held by any person treated as a settlor or beneficiary of all or a portion of the trust, or any other natural person exercising ultimate effective control over the trust. The reference to any other natural person exercising ultimate effective control over the trust, at a minimum, will include the trustee as an equity interest holder. Further, a discretionary beneficiary will only be treated as an account holder in the years in which it receives a distribution from the trust. If a settlor, beneficiary or other person exercising ultimate effective control over the trust is itself an entity, that entity must be looked through, and the ultimate natural controlling person(s) behind that entity must be treated as the equity interest holder. Currently, it is the understanding of the IRD that the term “entity” used here does not include a person excluded from the definition of reportable person. The term “controlling persons” as applies in the context of passive NFEs will also apply here, which also corresponds to the term “beneficial owner” as described in Recommendation 10 and the Interpretive Note of Recommendation 10 contained in the 2012 FATF Recommendations.

Identifying the reportable accounts of a trust that is a reporting financial institution

21. The debt and equity interests of the trust are reportable accounts if they are held

by a reportable person. For example, if a settlor or beneficiary is resident in a reportable jurisdiction, their equity interest is a reportable account.

Applying the due diligence rules

22. The trust will apply the due diligence rules in Schedule 17D of the IRO in order to determine the identity and residence of its account holders.

23. Where an equity interest (such as the interest held by a settlor or beneficiary) is held by an entity, the equity interest holder will instead be the controlling persons of that entity. As such, the trust will be required to look through a settlor or beneficiary that is an entity to locate the relevant controlling person. It is the current understanding of the IRD that the term "entity" used above does not include a person excluded from the definition of reportable person. The look through obligation should correspond to the obligation to identify the beneficial owner of a trust under AML/KYC procedures. In respect of preexisting accounts, reporting financial institutions may rely on the information collected in connection with the account pursuant to their AML/KYC procedures. In respect of new accounts, reporting financial institutions, in addition to other due diligence procedures, can rely on AML/KYC procedures to determine the identity of the controlling persons exercising ultimate control if these procedures are in accordance with the 2012 FATF Recommendations.

Reporting the relevant information

24. A trust that is a reporting financial institution will report the account information and the financial activity for the year in respect of each reportable account. The account information includes the identifying information for each reportable person (such as name, address, jurisdiction of residence, TIN, date of birth and account number), and the identifying information of the trust (name and identifying number of the trust). It is possible that a trust that is a financial institution may not have an account number for each of the equity interest holders. The trust should in that case use a unique identifying number that will enable the trust to identify the subject of the report in the future.

25. The financial activity includes the account balance or value, as well as gross payments paid or credited during the year.

26. The account balance is the value calculated by the reporting financial institution (the trust) for the purpose that requires the most frequent determination of value. For settlors and mandatory beneficiaries, for example, this may be the value that is used for reporting to the account holder on the investment results for a given

period. If the financial institution has not otherwise recalculated the balance or value for other reasons, the account balance for settlors and mandatory beneficiaries may be the value of the interest upon acquisition or the total value of all trust property.

27. Where an account is closed during the year, the fact of closure is reported. A debt or equity interest in a trust could be considered to be closed, for example, where the debt is retired, or where a beneficiary is removed.

28. The financial information to be reported will depend on the nature of the interest held by each account holder. Where the trust does not otherwise calculate the account value held by each account holder, or does not report the acquisition value, the account balance or value to be reported is as shown in the table below. Note that where a settlor or beneficiary is an entity (also refer to paragraph 23 above), the account holder will be the controlling persons of that entity.

The financial activity to be reported where a trust is a financial institution that does not otherwise calculate the account value

Account holder	***Account balance or value***	***Gross payments***
Settlor	• Total value of all trust property	• Value of payments made to the settlor in reporting period (if any)
Beneficiary: mandatory	• Total value of all trust property	• Value of distributions made to the beneficiary in reporting period
Beneficiary: discretionary (in a year in which a distribution is received)	• Nil	• Value of distributions made to the beneficiary in reporting period
Any other person exercising ultimate effective control	• Total value of all trust property	• Value of distributions made to such person in reporting period (if any)
Debt interest holder	• Principal amount of the debt	• Value of payments made in reporting period
Any of the above, if account was closed	• The fact of closure	• Value of payments made to the account holder in reporting period

The treatment of a trust that is an NFE

29. If an NFE holds an account with a reporting financial institution, the reporting financial institution may be required to report the trust for purposes of AEOI. This part describes how the relevant provisions apply to a trust that is an NFE.

30. The same five steps will apply: (a) reporting financial institutions; (b) review their financial accounts; (c) to identify their reportable accounts; (d) by applying the due diligence rules; and (e) then report the relevant information. Assuming here that the first two steps are met (a trust has a financial account with a reporting financial institution), the following paragraphs set out the determination of whether the trust is a reportable person, the due diligence rules that are applied by the reporting financial institution to the trust, and the information to be reported by the reporting financial institution about the trust.

Identifying whether the account held by the trust is a reportable account

31. The account held by a trust that is a passive NFE is a reportable account if: (a) the trust is a reportable person; or (b) the trust has one or more controlling persons that are reportable persons.

32. The trust will be a reportable person only if it is subject to taxation as a resident in a reportable jurisdiction and is not excluded from the definition of reportable person. In many cases a trust would not be subject to taxation on its income in any territory (i.e. has no residence for tax purposes). In that case, it is necessary to identify the territory in which the effective management of the trust is situated.

33. The account held by a trust will also be reportable if the trust has one or more controlling persons that are reportable persons. The controlling persons of a trust are the settlor(s), trustee(s), beneficiary/ies, protector(s) and any other natural person exercising ultimate effective control over the trust. This definition of controlling person excludes the need to inquire as to whether any of these persons can exercise practical control over the trust.

34. Where the beneficiaries are not individually named but are identified as a class, it is not required to treat all possible members of the class as reportable persons. Rather, when a member of a class of beneficiaries receives a distribution from the trust or intends to exercise vested rights in the trust property, this will be a change of circumstances, prompting additional due diligence and reporting as necessary. This reflects a similar obligation contained in the 2012 FATF Recommendations (see

Interpretive Note to Recommendation 10, at footnote 31).

35. A settlor is reported regardless of whether it is a revocable or irrevocable trust. Likewise, both mandatory and discretionary beneficiaries are included within the definition of controlling persons. Unlike the case of an equity interest in a trust that is a reporting financial institution, discretionary beneficiaries would be reported regardless of whether a distribution is received in a given year. However, reporting financial institutions may align the scope of the beneficiaries of a trust reported as controlling persons of the trust with the scope of the beneficiaries of a trust treated as reportable persons of a trust that is a financial institution. In such case the reporting financial institution would only need to report discretionary beneficiaries in the year they receive distributions from the trust. Where financial institutions make use of this option, they must ensure that appropriate procedures must be in place to identify when a distribution is made to a discretionary beneficiary of the trust in a given year that enables the trust to report such beneficiary as a controlling person to the financial institution. For instance, the reporting financial institution requires a notification from the trust or trustee that a distribution has been made to that discretionary beneficiary.

36. The definition of controlling person also includes any natural person(s) that exercise ultimate control of an entity that is a settlor, trustee, beneficiary or protector. For example, where the settlor or beneficiaries are themselves entities, the reporting financial institution must identify the natural person(s) exercising control of that entity. Although the natural person may be exercising ultimate control through a chain of ownership, only the ultimate natural controlling person(s) would be treated as a controlling person, and not the intermediary entities in the chain of ownership. The requirement to identify the natural persons will apply consistent with FATF Recommendations.

37. In the event that a controlling person of a trust that is a passive NFE is not a resident for tax purposes of any reportable jurisdiction, that controlling person would not be considered a reportable person.

Applying the due diligence rules

38. The reporting financial institution must apply the due diligence rules to determine if the account held by the trust is a reportable account.

39. Reporting financial institutions may rely on information collected pursuant to AML/KYC procedures to identify the controlling persons. In respect of pre-existing entity accounts, reporting financial institutions may rely on the information collected in connection with the account pursuant to their AML/KYC procedures. In respect

of new entity accounts, reporting financial institutions can only rely on AML/KYC procedures to determine the identity of controlling persons if these procedures are in accordance with the 2012 FATF Recommendations.

Reporting the relevant information

40. Where a trust is a reportable person, the reporting financial institution will report the account information and the financial activity for the year with respect to the account of the trust. The account information includes the identifying information for each reportable person (such as name, address, jurisdiction of residence, TIN, date of birth and account number), and the identifying information of the reporting financial institution (name and identifying number).

41. In respect of a trust that is a passive NFE, the reporting financial institution must report the controlling persons of the trust. Where the reporting financial institution has information available that identifies the type of each controlling person (i.e. whether it is the settlor, trustee, protector or beneficiary), this information is also expected to be reported. Including this information in reports will significantly increase the usefulness of the data to the receiving jurisdiction and benefit the controlling persons themselves due to the increased clarity in relation to their status. With respect to new entity accounts, given that the AML/KYC procedures require the identification of the settlor, trustees, beneficiaries, protectors and any other natural person exercising ultimate effective control of the trust, reporting financial institutions should have this information available.

42. The financial information to be reported will be the account balance or value of the account held by the trust and payments made or credited to such account. Each controlling person is attributed the entire value of the account, as well as the entire amounts paid or credited to the account, as shown in the table below.

43. Where the financial account held by the trust is closed during the year, both the fact of closure of the account and the gross payments made or credited to the account during the relevant reporting period are to be reported.

The financial activity to be reported where a trust is a passive NFE

Account Holder	***Account Balance or Value***	***Gross Payments***
Settlor	• Total account balance or value	• Gross payments made or credited to the account as per section 50F of the IRO

Trustee	• Total account balance or value	• Gross payments made or credited to the account as per section 50F of the IRO
Beneficiary: mandatory	• Total account balance or value	• Gross payments made or credited to the account as per section 50F of the IRO
Beneficiary: discretionary (if the option at paragraph 35 is exercised)	• Nil	• Gross payments made or credited to the account as per section 50F of the IRO
Protector (if any)	• Total account balance or value	• Gross payments made or credited to the account as per section 50F of the IRO
Any of the above, if account was closed	• The fact of closure	• Gross payments made or credited to the account as per section 50F of the IRO

44. The reports will be sent bilaterally. For example, consider a trust that is a passive NFE with one or more controlling person. The controlling persons of the trust are all reportable persons: (a) settlor resident in jurisdiction A; (b) trustee resident in jurisdiction B; and (c) beneficiary resident in jurisdiction C. The reporting financial institution is resident in jurisdiction X and will send the reportable information to its Competent Authority. The Competent Authority will then exchange the following reports (assuming that in jurisdiction X, each of jurisdictions A, B and C are reportable jurisdictions):

Reportable jurisdiction	***Subject of information report***
A	• The settlor resident in Jurisdiction A as a controlling person of a passive NFE
B	• The trustee resident in Jurisdiction B as a controlling person of a passive NFE
C	• The beneficiary resident in Jurisdiction C as a controlling person of a passive NFE