

## CHAPTER 5

### FINANCIAL ACCOUNTS

A financial account is an account maintained by a reporting financial institution. Only accounts that fall within the meaning of financial account as defined by section 50A of the IRO need to be reviewed. Where such an account is held by a reportable person it becomes a reportable account.

2. The 5 categories of financial account that need to be reviewed are:

<i>Accounts</i>	<i>Which financial institution is generally considered to maintain them</i>
Depository accounts	The financial institution that is obligated to make payments with respect to the account (excluding an agent of the financial institution).
Custodial accounts	The financial institution that holds custody over the assets in the account.
Equity and debt interests in investment entities	The investment entity that maintains the equity or debt interest.
Cash value insurance contracts	The financial institution that is obligated to make payments with respect to the contract.
Annuity contracts	The financial institution that is obligated to make payments with respect to the contract.

3. Certain financial accounts are seen to be low-risk of being used to evade tax and are specifically excluded from needing to be reviewed. Details of these excluded accounts are at Chapter 6.

4. The definition of a financial account does not extend to shareholdings on an issuer's share register nor debenture/loan stock holdings (including shareholdings which have been the subject of an acquisition, as a result of which the original share register no longer exists). However shareholdings and loan/debenture stock holdings by a financial institution can be "financial instruments/contracts" and are reportable if held in a custodial account.

## Executing brokers and placing agents

5. Where a financial institution is acting as an executing broker, and simply executing trading instructions, or receiving and transmitting such instructions to another executing broker, (either through Hong Kong Stock Exchange, multilateral trading facility or equivalent of such, a clearing organisation or on a bilateral basis) then the financial institution will not be required to treat the facilities established for the purposes of executing a trading instruction, or receiving and transmitting such instructions, as a financial account under the agreement. In these cases the financial institution acting as custodian will be responsible for performing due diligence procedures and reporting where necessary.

6. It is also possible that a financial institution acting as an executing broker may be subject to failed trades and find themselves with the legal ownership of the asset that they intended to broker. In this case neither the holding of the asset, nor any resultant claims (market claims such as the passing of entitlement on dividend and coupon payments, claims compensated through a clearing house, securities depository etc.) will lead to a financial account being established by the executing broker.

7. In certain circumstances “placing agents” will typically acquire shares for a 2-3 day period (maximum 7 days) and hold these as nominee for an underlying investor. The placing agent will also have cash funds deposited by the investor for a similar period. The two would ultimately be matched and the shares delivered to the designated custodian of the investor. To eliminate the creation of a series of custodial accounts which would open and close in a 2-3 day window and therefore be potentially reportable such funds will not be regarded as financial accounts provided that:

- (a) the account is established and used solely to secure the obligation of the parties to the transaction.
- (b) the account only holds the monies appropriate to secure an obligation of one of the parties directly related to the transaction, or a similar payment, or with a financial asset that is deposited in the account in connection with the transaction.
- (c) the assets of the account, including the income earned thereon, is paid or otherwise distributed for the benefit of the parties when the transaction is completed.

## **Reportable account**

8. Once a financial institution has identified the financial accounts it maintains it needs to review all those accounts to identify the territory in which the account holder is tax resident and maintain the information for future use. This is the wider approach. To the extent that any of the account holders are identified as tax resident in one or more reportable jurisdictions the account will be a reportable account which must be reported to the IRD.

9. A reportable account is an account held by one or more reportable persons or by a passive NFE with one or more controlling persons that is a reportable person.

## **Depository account**

10. A depository account includes any commercial current, savings, time or thrift account, or any account evidenced by a certificate of deposit, investment certificate, thrift certificate, certificate of indebtedness, or other similar instrument where cash is placed on deposit with an entity engaged in a banking or similar business. Being engaged in a banking or similar business is explained at Chapter 3.

11. A depository account does not have to be an interest bearing account.

12. A depository account can include a credit balance on a credit card, for example where a purchase has been refunded, provided the credit card has been issued by a credit card company engaged in banking or a similar business.

13. Credit cards will not be reportable as depository accounts if the credit card issuer meets the conditions to be a qualified credit card issuer and is therefore a non-reporting financial institution. Similarly, where a financial institution does not satisfy the requirements to be a qualified credit card issuer, but accepts deposits when a customer makes a payment in excess of a balance due with respect to a credit card or other revolving credit facility, it may still not have to report the account as a depository account if it qualifies as an excluded account.

## **Custodial account**

14. A custodial account is an account (other than an insurance contract or annuity contract) for the benefit of an individual or entity that holds one or more financial assets.

15. A cash value insurance contract or an annuity contract is not considered to be a custodial account, but these could be assets held in a custodial account. Where they are assets in a custodial account, the insurer will only need to provide the custodian with the balance or value of the cash value insurance contract.

16. A custodial account does not include financial instruments or contracts (for example, a share or stock in a corporation) held in a nominee sponsored by the issuer of its own shares, which are in every other respect analogous to those held on the issuer's share register.

### *Collateral*

17. Collateral accounts are accounts which are maintained for the benefit of another, or arrangements pursuant to which an obligation exists to return cash or assets to another.

18. Transactions which include the collection of margin or collateral on behalf of a counterparty may fall within the definition of custodial account. The exact terms of the contractual arrangements will be relevant in applying this interpretation. However, if collateral is provided on a full title transfer basis, so that the collateral holder becomes the full legal and beneficial owner of the collateral during the term of the contract, this will not constitute a custodial account for the purposes of AEOI.

### *Syndicated loans*

19. Where a borrower requires a large or sophisticated facility, or multiple types of facility, this is commonly provided by a group of lenders, known as a syndicate, under a syndicated loan agreement.

20. To facilitate the process of administering the loan on a daily basis, one member of the syndicate is typically appointed as Agent. The Agent's role is to act as the agent for the lenders and to coordinate and administer all aspects of the loan once the loan agreement has been executed, including acting as a point of contact between the borrower and the lenders in the syndicate and monitoring the compliance of the borrower with the terms of the facility.

21. The Agent performs exclusively operational functions. For example, the borrower makes all payments of interest and repayments of principal and any other payments required under the loan agreement to the Agent and the Agent then distributes these monies to the syndicate members as required by the syndicate agreement. Similarly, the lenders advance funds to the borrower through the Agent. The terms of a syndicated loan agreement usually entitle the Agent to undertake the roles described above in return for a fee.

22. In these circumstances the participation of a lender in a syndicated loan, where a reporting financial institution is the agent acting for and on behalf of the syndicate, does not lead to the creation of a custodial account held by the agent.

### **Cash value insurance contract**

23. A cash value insurance contract is an investment product that has an element of life insurance attached to it. The life insurance element is often small compared to the investment element of the contract. General insurance products, such as term life insurance, property or motor insurance, that do not carry any investment element are not financial accounts.

24. A cash value insurance contract is an insurance contract where the policyholder is entitled to receive payment on surrender or termination of the contract. An insurance contract will also be a cash value insurance contract where the policyholder can borrow against the contract, for example by using the contract as collateral for borrowing, the contract being acceptable as collateral because of the associated cash value.

25. Other types of general insurance may be used as collateral, for example key man insurance, but these are not cash value insurance contracts because the collateral is not reliant on any payment on surrender or termination of the contract. Rather the collateral is based on the assignment of the benefits of the contract to the lender in the event that the contingency insured against comes about.

26. The cash value of a cash value insurance contract is the greater of:

- (a) The amount that the policyholder is entitled to receive on the surrender or termination of the contract without reduction for any surrender charge or loans outstanding against the policy, for example, where the policyholder receives an annual statement of the value of the policy that will be the cash value in that year, and
- (b) The amount the policyholder can borrow against or with regard to the policy. Note that the policyholder does not need to have pledged the account as collateral for borrowing for this second test to apply. It is the amount that the policyholder could expect to borrow against the cash value insurance contract should they choose to use it as collateral for a loan.

27. The cash value does not include any amount payable under an insurance contract:



- (a) solely by reason of the death of an individual insured under a life insurance contract;
- (b) as a personal injury, sickness or other benefit providing indemnification of an economic loss arising from an event that has been insured against;
- (c) as a refund of premium due to the cancellation or termination of an insurance contract, a reduction in the amount insured or a correction of a posting or similar error in relation to the premium;
- (d) as a policyholder dividend, other than a termination dividend, provided that the insurance contract pays only the benefits in (b) above. A policyholder dividend is the return of premium, under the terms of the policy, resulting from an excess of income over losses and expenses.
- (e) as a return of an advance premium or premium deposit for an insurance contract where the premium is payable at least annually. In this case the advance premium or premium deposit must not exceed the amount due as the next annual premium payable under the contract.

28. Cash value insurance contracts do **not** include general insurance policies or term life insurance contracts including:

- (a) indemnity insurance contracts between insurance companies.
- (b) policies indemnifying against economic loss arising from specified circumstances, for example personal injury, theft, etc.
- (c) micro insurance contracts that do not have a cash value.

### **Annuity contracts**

29. An annuity contract is a contract under which the issuer agrees to make payments for a period of time, determined in whole or in part by reference to the life expectancy of one or more individuals. Reinsurance of annuity contracts between insurance companies are not annuities.

### **Equity and debt interest**

30. In general, equity and debt interests are financial accounts only to the extent that they are interests in an investment entity.

31. Where an entity is an investment entity solely because it acts on behalf of a customer by investing, managing or administering financial assets in the name of the customer, the debt and equity interest in the investment entity are not financial accounts provided it renders only investment advice to, or manages portfolios for, the customer.
32. An equity interest may vary depending on the nature of the investment entity. In the case of an investment entity that is a partnership an equity interest is either a capital or profits interest in the partnership.
33. In the case of a trust an equity interest is any interest held by a person who is treated as a settlor or beneficiary of all or any part of the trust, or any other natural person exercising ultimate effective control over the trust.
34. A reportable person will be treated as being a beneficiary of a trust if such a person:
- (a) has the right to receive a mandatory distribution from the trust and this distribution can be received either directly or indirectly, for example through a nominee; or
  - (b) may receive a discretionary payment from the trust and this receipt can be either directly or indirectly from the trust.