

US Foreign Account Tax Compliance Act Intergovernmental Agreement

Frequently Asked Questions

This document aims to provide background information regarding the intergovernmental agreement (“IGA”) to be signed between Hong Kong and the US for implementation of the US Foreign Account Tax Compliance Act (“FATCA”). This document is not and should not be regarded as tax advice for financial institutions and their clients. If in doubt, individual institutions or clients should seek professional advice from their own tax or legal advisers. Information provided in this document will be updated according to the development regarding the signing of the IGA.

Q 1: What is FATCA? Does this US tax legislation have any implication for Hong Kong?

A 1: FATCA was enacted by the US in March 2010 aiming to combat tax evasion by US taxpayers. In brief, under FATCA, foreign financial institutions (“FFIs”) are required to sign agreements with the US Internal Revenue Service (“IRS”) to identify and disclose detail regarding their US account holders. These financial institutions will be required to withhold tax for relevant US account-holders who do not give consent to such disclosures, or to close such accounts.

An FFI which does not sign or is not otherwise exempt will face a punitive 30% withholding tax on all “withholdable payments” derived from US sources, initially including dividends, interest and certain derivative payments. In addition, starting from 2017, gross proceeds such as sales proceeds and returns of principal derived from stocks and debt obligations generating US source dividends or interest will be treated as “withholdable payments”.

Q 2: What is an IGA under FATCA?

A 2: The US Treasury announced in June 2012 its intention to sign IGAs under FATCA with other jurisdictions, in order to simplify due diligence and disclosure requirements, reduce or eliminate conflicts with local legislation, and eliminate certain withholding requirements.

The US has developed two Model IGAs to simplify the implementation of FATCA. Model I establishes a framework of reporting account information on US persons by financial institutions to the relevant domestic authority which in turn provides the information to the US IRS. As at 1 July 2014, 34 jurisdictions including Australia, Canada, France, Germany and the United Kingdom have signed Model I IGA with the US.

Having regard to our tax legislation, Hong Kong has opted for a Model II IGA with the US. Austria, Bermuda, Chile, Japan and Switzerland have signed Model II IGAs with the US. Model II establishes a framework of enabling relevant financial institutions in Hong Kong to seek consent for disclosure from US clients, and to report relevant tax information of such clients to the US IRS. This model of IGA will be supplemented by the operation of a tax information exchange agreement.

Q 3: Why does Hong Kong have to enter into an IGA with the US ?

A 3: The purpose of FATCA is to combat tax evasion by US taxpayers using offshore financial accounts. The compliance requirements of FATCA have caused serious concerns in the financial markets. Moreover, FFIs that do not comply with FATCA will be subject to a 30% withholding tax on certain types of US-sourced payments. An IGA with the US will provide additional exemptions and simplified reporting and due diligence procedures to minimise the compliance burden of financial institutions in Hong Kong.

Q 4: What are the obligations when a financial institution in Hong Kong enters into a FFI agreement with the US IRS?

A 4: According to the FFI Agreement published by the US IRS, financial institutions in Hong Kong shall, when Hong Kong has reached an IGA in substance with the US, –

- (a) use established due diligence (i.e. “know-your-customer”) procedures under the prevailing anti-money laundering legislation to identify US accounts and clients;
- (b) obtain a consent of relevant US clients (including individuals and entities) for reporting their relevant account balances, gross amounts of relevant interest incomes, dividend incomes and withdrawals, and identification details (e.g. name, address, the US federal taxpayer identifying numbers, known as “TIN”) to the US IRS annually. The first reporting deadline will be 31 March 2015 (in respect of the year-end information in 2014); and
- (c) report “aggregate information” of account balances, payment amounts and number of non-consenting US accounts to the US IRS. Based on such aggregate information, the US IRS may lodge to our Inland Revenue Department, where necessary, requests for exchange of information (“EoI”) on a group basis pursuant to the EoI framework provided for under the tax information exchange agreement that Hong Kong signed with the US on 25 March 2014.

Please refer to the relevant US IRS webpage for details:

<http://www.irs.gov/Businesses/Corporations/Information-for-Foreign-Financial-Institutions>

Q 5: Are all financial institutions in Hong Kong obliged to comply with FATCA even though some of them may not have any US client?

A 5: All financial institutions meeting the criteria of FFIs under FATCA such as banks, investment entities, insurance companies, custodial institutions,

and unless otherwise exempt, must register with the US IRS and comply with the terms of FFI agreement. Otherwise they will be subject to a 30% withholding tax on relevant US-sourced payments to them.

Q 6: What kind of client information do financial institutions in Hong Kong have to provide to US IRS in order to comply with FATCA?

A 6: With the consent of their US clients, financial institutions in Hong Kong have to report to the US IRS their US clients' identification details (e.g. name, address, the US federal taxpayer identifying numbers, known as "TIN", and the prescribed type of entity if the client is an entity), the relevant account balances, gross amounts of relevant interest incomes, dividend incomes and withdrawals. If their US clients refuse to give any consent to report their account information, financial institution concerned should report "aggregate information" of account balances, payment amounts and number of non-consenting US accounts to the US IRS. Based on such aggregate information, the US IRS may lodge to our Inland Revenue Department, where necessary, requests for EoI on a group basis pursuant to the EoI framework provided for under the tax information exchange agreement that Hong Kong signed with the US on 25 March 2014.

Q 7: FATAC requires financial institutions in Hong Kong to report their US client information to the US IRS. How should financial institutions protect the privacy of Hong Kong residents?

A 7: Financial institutions in Hong Kong would only provide the relevant account information of their US clients to the US IRS with their clients' prescribed consent. The majority of Hong Kong residents are not US taxpayers. Their personal data is not subject to reporting under FATCA. In any circumstances, financial institutions in Hong Kong cannot provide their clients' information to any unauthorized third party without their clients' prescribed consent.

Q 8: How does an IGA between Hong Kong and the US help minimise the compliance burden of FATCA ?

A 8: According to the IGA reached in substance between Hong Kong and the US -

- (a) financial institutions in Hong Kong complying with the respective FFI Agreements will not be subject to a 30% withholding tax in respect of relevant US-sourced payments by institutions in the US or other FFIs owing to their own FATCA obligations. This will certainly help safeguard the interest of all depositors, insurance policy holders, investors and other clients of Hong Kong financial institutions in Hong Kong;
- (b) the US IRS will waive the requirements under the relevant US Internal Revenue Code for financial institutions in Hong Kong to withhold tax on payments to recalcitrant accounts (i.e. accounts of which the holders do not consent to FATCA reporting and disclosure to the US IRS) or close those recalcitrant accounts;
- (c) for group institutions with worldwide operations, their Hong Kong operations shall continue to be treated as FATCA-compliant despite any non-compliance of a related entity operated in a jurisdiction that prevents its compliance with FATCA;
- (d) financial institutions in Hong Kong may rely on a set of streamlined due diligence procedures as stated in Annex I to the IGA to screen and identify US indicia in order to locate US accounts and clients for reporting purposes. This will minimise compliance burdens of financial institutions in Hong Kong and inconvenience for other account holders who are not the targets of FATCA; and
- (e) A wide range of entities, financial institutions and products including, among others, mandatory provident fund schemes, other retirement products that fall within the specified criteria, institutions

with a predominately local clientele, shall be exempt under Annex II to the IGA in view of the low risks of themselves being used by US taxpayers for tax evasion.

Please refer to the Annexes I and II of standard Model II IGA template promulgated at the relevant US Department of Treasury (“US Treasury”) website for details of the standard streamlined due diligence procedures and exemption arrangements:

<http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx>

Q 9: Would a Hong Kong financial institution be affected if their related entity abroad does not comply with FATCA?

A 9: The FATCA compliant status of a Hong Kong financial institution would not be affected despite any non-compliance of a related entity operated in a jurisdiction that prevents its compliance with FATCA. However, a financial institution in Hong Kong would be treated as non-compliant if its related entity operated in other jurisdiction does not comply with FATCA for other reasons.

Q 10: Are all financial institutions in Hong Kong required to register with the US IRS?

A 10: Unless the financial institutions are exempt from registration under the IGA, such as exempt beneficial owners and certified deemed-compliant foreign financial institutions, all other financial institutions treated as FFIs under the IGA have to register with the US IRS at the specified US IRS website. A Global Intermediary Identification Number (“GIIN”) will be assigned by the US IRS to a financial institution completing the registration process for identification. The US IRS has provided a list of all participating FFIs at a specified date at its website since 2 June 2014 and will update the list every month.

Please refer to the relevant US IRS website for details:

<http://www.irs.gov/Businesses/Corporations/FATCA-Registration>

Q 11: Is there any financial institution or product in Hong Kong exempt from compliance with FATCA owing to the IGA? If so, are their due diligence and reporting obligations under FATCA waived entirely?

A 11: Annex II of an IGA contains a list of exemptions for entities, financial institutions and financial products which otherwise may fall within FATCA reporting and withholding rules. Some exemptions are waiving a wide range of compliance obligations. Some are partial exemptions requiring the institutions concerned to register with the US IRS for reduced compliance requirements.

Please refer to the Annex II of Model II IGA template posted on the relevant US Treasury's website:

<http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA.aspx>

According to the consensus reached by Hong Kong and the US, the following entities, institutions and financial products would be exempt from a wide range of or certain compliance obligations under the IGA to be signed by Hong Kong and the US –

(I) Exemptions as “exempt beneficial owners”

(a) HKSAR Government and all statutory bodies;

(b) all Mandatory Provident Fund (“MPF”) schemes;

(c) certain retirement products that fall within the specified criteria;

(d) the Grant Schools Provident Fund and the Subsidized Schools Provident Fund; and

(e) international organisations based in Hong Kong.

(II) Partial exemptions as “registered deemed-compliant FFIs” or “certified deemed-compliant FFIs”

- (a) financial institutions licensed and regulated under the laws of the HKSAR with no fixed place of business outside of Hong Kong and the Mainland, and with a client base comprising predominantly residents of Hong Kong or the Mainland (by applying a threshold of 98% of financial accounts by value);
 - (b) all credit unions, as well as certain depository institutions (e.g. deposit-taking companies) with an asset value of less than US\$175 million on their own balance sheet;
 - (c) certain credit card issuers that impose restrictions on clients keeping a debit (deposit) balance on the accounts;
 - (d) certain regulated collective investment schemes; and
 - (e) investment advisers and investment managers.
- (III) Exemptions of financial products from being “financial accounts”
- (a) certain term life insurance contracts which have no contract value that any person can access without terminating the contracts; and
 - (b) certain employee incentive share schemes, such as share option schemes, share award schemes, employee share purchase schemes, share appreciation rights schemes, usually established by listed corporations.

Q 12: My company operates an occupational retirement scheme under the Occupational Retirement Schemes Ordinance (“ORSO”). Would the company’s occupational retirement scheme be exempt from registration and reporting obligation under the IGA?

A 12: Apart from MPF schemes, certain retirement funds are exempt from registration and reporting obligation under the IGA. These retirement products include all ORSO schemes that are registered with the Mandatory Provident Fund Schemes Authority (“MPFA”) in accordance with the ORSO (i.e. the ORSO registered schemes) and satisfy certain specified criteria.

The specified criteria, in essence, include-

- An ORSO registered scheme that does not have a single beneficiary with a right to more than five percent of the scheme’s assets; or
- An ORSO registered scheme with a limited size that satisfies the following criteria:
 - (a) the scheme has fewer than 50 participants;
 - (b) the scheme is sponsored by one or more employers that are not investment entities or passive non-financial entity under FATCA;
 - (c) the employee and employer contributions to the fund are limited by reference to earned income and compensation of the employees; and
 - (d) participants that are not residents of the HKSAR are not entitled to more than 20 percent of the fund’s assets.

All other ORSO schemes that could not satisfy the said criteria including “ORSO exempted schemes”, i.e. ORSO schemes which are granted exemption certificates by MPFA, would not be exempt from FATCA registration and reporting. (For information regarding registration with the relevant authority of the US, please see Q.10)

Q 13: How can Hong Kong residents and financial institution verify whether a Hong Kong or foreign financial institution has complied with FATCA to avoid unnecessary withholding on their US-sourced payments?

A 13: Unless the financial institutions are exempt from registration under the IGA, such as exempt beneficial owners and certified deemed-compliant foreign financial institutions, all other financial institutions treated as FFIs under the IGA have to register with the US IRS at the specified US IRS website. A GIIN will be assigned by the US IRS to a financial institution after completing the registration process for identification. The US IRS has provided a list of all participating FFIs at a specified date and tools for searching and identifying participating FFIs and their GIINs from the list at its website since 2 June 2014. The US IRS said that the list will be updated every month.

Please refer to the relevant US IRS webpage for details:

<http://www.irs.gov/Businesses/Corporations/FATCA-Foreign-Financial-Institution-List-Search-and-Download-Tool>

Depositors, investors and financial institutions in Hong Kong can enquire their related financial institutions regarding their compliance with FATCA. They can also verify the participation status of the related financial institutions at the relevant US IRS website.

Q 14: When does the Government expect to announce the signing of an IGA with the US

A 14: Hong Kong and the US have reached consensus on the substance of an IGA. We will sign the IGA with the US when the US completes its relevant due process. We will then make appropriate announcement after signing, and remind financial institutions through our financial regulators to prepare for FATCA compliance and register with the US IRS timely.

Q 15: What is the progress of the US in signing IGAs with other jurisdictions?

A 15: As at 1 July 2014, 39 jurisdictions have signed IGAs with the US including 34 on Model I and 5 on Model II. In early April 2014, the US

Government announced that jurisdictions that had reached agreements in substance with the US on the terms of IGAs before 1 July 2014 could be treated as having IGAs in effect until the end of 2014 providing that the jurisdictions consent to having their status of agreement disclosed. In addition to Hong Kong, more than 50 jurisdictions are treated as having IGAs in effect with the US.

Please refer to the relevant US Treasury webpage for details:

<http://www.treasury.gov/resource-center/tax-policy/treaties/Pages/FATCA-Archive.aspx>

Financial Services and the Treasury Bureau
3 July 2014