Consultation Paper Feedback - Implementation of Crypto-Asset Reporting Framework ("CARF") and amendments to Common Reporting Standard ("CRS")

A. Financial Services and the Treasury Bureau ("FSTB") and Inland Revenue Department ("IRD") questions

In relation to the implementation of CARF in Hong Kong

1. Will you, as RCASPs, identify and collect information of both reportable and non-reportable persons?

Yes, the collection of information of both reportable and non-reportable persons would enable the RCASPs to implement a standardised onboarding and collection of self-certification form process without having to determine whether the user is reportable or non-reportable person.

2. Do you have any views on the proposed record keeping requirements for RCASPs?

In case of merger and acquisition transactions (which are later dissolved or business terminated), there is a possibility that the director of the acquiring / merged entity will be held liable if the predecessor director did not complete his obligations with respect to record keeping. The legislation should specifically consider such cases where provisions are made to ensure that the lapses in terms of record keeping requirements by the predecessor director do not lead to sanctions for the new director.

It is also important to clarify whether dissolution-related requirements are in line with the broader Hong Kong data retention framework beyond CARF. If they are not, this could have wider implications that must be properly addressed.

3. Do you have any views on the proposed mandatory registration for all RCASPs that meet any of the reporting nexus with Hong Kong?

No comments. However, it would be helpful if the list of registered RCASPs is made publicly accessible to support the classification process.

4. Do you have any views on the proposed penalty framework for CARF (including the administrative penalty mechanism)?

a) No comments on the quantum of the penalty provisions except to include a section for avoiding duplication of liability to penalties in respect of the same act or omission. Similar provisions in the UK CRS laws reproduced below:

ASIA SECURITIES INDUSTRY & FINANCIAL MARKETS ASSOCIATION | Unit 3603, Tower 2 Lippo Centre | 89 Queensway Admiralty, Hong Kong | Tel: +852 2531 6500 www.asifma.org

Duplication of liability to penalties

22J.—*(1) A reporting financial institution or UK representative cannot be liable to penalties under any two or more of regulations 22A (failure to comply with due diligence procedures), 22B (failure to comply with record-keeping requirements), and 22D (inaccurate or incomplete reports) in respect of the same act or omission.*

(2) Where, apart from paragraph (1), a reporting financial institution or UK representative would be so liable, the reporting financial institution or UK representative is liable to a penalty in respect of that act or omission under whichever of regulations 22A, 22B and 22D is, in the opinion of an officer of Revenue and Customs, correct or appropriate in the circumstances.

b) It would also be helpful to understand as to what constitutes "knowingly" or "recklessly" in terms of the enhanced sanctions and provide sufficient administrative guidance in the legislation in this regard.

c) The Consultation Paper mentions that the enforcement provisions would empower the IRD to have access to business premises of RCASPs or their service providers and inspect their compliance system and process. However, it might be difficult to have access to a service provider in case they are in a different jurisdiction. The proposed penalty framework for CARF should not place undue burdens on service providers and should be carefully considered to foster the development of the various verticals of the overall industry.

d) Some of our members find it unreasonable to obtain a search warrant as means to enforce compliance with the RCASPs / service providers.

5. Do you have any views on the proposed filing mechanism for CARF Returns?

The Consultation Paper mentions that an RCASP that does not have any CARF information to report in a particular year will still be required to file a nil return and provide reasons.

Reasons for nil reporting include: (a) the RCASP has complied with the reporting and due diligence requirements under CARF in another jurisdiction; (b) the RCASP has not yet commenced business involving relevant crypto-assets and relevant transactions; (c) all of the crypto-asset users of the RCASP are not residents of reportable jurisdictions (the total number of crypto-asset users during the information period should be provided); (d) the RCASP has no business involving relevant crypto-assets or has not executed any relevant transactions during the information period; and (e) other reasons to be specified.

If an RCASP has not commenced business involving relevant crypto assets as mentioned in the reasons above, it should not fall under the definition of an RCASP under CARF and therefore there should not be a reason to register and file a nil return. It would be helpful to understand practical cases or clarifications with this respect.

Also, we suggest that these reasons be pre-populated at the time of filing of Nil returns.

6. Will you prefer using self-developed software or the data preparation tool provided by IRD in the CARF Portal for preparation of data files?

The RCASPs may prefer using non-IRD software as external vendors would be engaged for reporting purposes.

In relation to the implementation of amended CRS in Hong Kong

7. On reporting of gross proceeds from the sale or redemption of relevant crypto-assets, do you have any views on adopting the default treatment in requiring RFIs to report the relevant information under both CRS and CARF?

The legislation should allow RFIs / RCASPs to retain the option to choose as to whether they wish to go ahead with the default (reporting under both, CARF and CRS) or the optional method (not reporting under CRS as long as reported under CARF).

In relation to measures for strengthening the administrative framework for CRS

8. Do you have any views on the proposed mandatory registration for all RFIs in Hong Kong?

No comments. However, IRD should consider streamlining the current CRS notification process on commencing / ceasing / re-commencing to maintain a reportable account.

Further, we would encourage if the IRD would share further details with respect to the New Tax Portal ("NTP") at the earliest and envisage that an entity should be able to act for multiple underlying entities in a single log in under the NTP to reduce administration burden.

9. Do you have any views on the proposed amendments to the record keeping requirements for RFIs?

In case of merger and acquisition transactions (which are later dissolved or business terminated), there is a possibility that the director of the acquiring / merged entity will be held liable if the predecessor director did not complete his obligations with respect to record keeping. The legislation should specifically consider such cases where provisions are made to ensure that the lapses in terms of record keeping requirements by the predecessor director do not lead to sanctions for the new director.

It is also important to clarify whether dissolution-related requirements are in line with the broader Hong Kong data retention framework beyond CRS. If they are not, this could have wider implications that must be properly addressed.

10. Do you have any views on the enhanced penalty framework for CRS?

a) No comments on the quantum of the penalty provisions except to include a section for avoiding duplication of liability to penalties in respect of the same act or omission. Similar provisions in the UK CRS laws reproduced below:

Duplication of liability to penalties

22J.*—(1) A reporting financial institution or UK representative cannot be liable to penalties under any two or more of regulations 22A (failure to comply with due diligence procedures), 22B (failure to comply with record-keeping requirements), and 22D (inaccurate or incomplete reports) in respect of the same act or omission.*

(2) Where, apart from paragraph (1), a reporting financial institution or UK representative would be so liable, the reporting financial institution or UK representative is liable to a penalty in respect of that act or omission under whichever of regulations 22A, 22B and 22D is, in the opinion of an officer of Revenue and Customs, correct or appropriate in the circumstances.

b) It would also be helpful to understand as to what constitutes "knowingly" or "recklessly" in terms of the enhanced sanctions and provide sufficient administrative guidance in the legislation in this regard.

B. Other considerations:

1. It appears the OECD shall from time to time provide more guidelines on CARF / amended CRS via their FAQ documents. We suggest that the Hong Kong regulations and the IRD to formally recognize OECD's FAQs for the implementation and administration of CARF / amended CRS such that HK RCASPs and RFIs can place reliance on them.

2. With respect to the application of branch nexus in case of a staggered implementation as covered by FAQ 1.1 of OECD CARF, please clarify that a Hong Kong branch of a RCASP would only need to complete the reporting and due diligence requirements effectuated by such Hong Kong branch and does not need to cover transactions effectuated by jurisdictions that are committed to implement the CARF but without a specified date e.g. India or Vietnam.

FAQ 4.6 of OECD CARF

3. The relevant FAQ states that a digitally issued or tokenised Financial Asset does not fall within the definition of Crypto-Asset under Section IV(A)(1) of the CARF and Section VIII(A)(12) of the amended CRS where such disintermediation is not possible since the asset can, for regulatory or other legal reasons, only be held by and transferred through Custodial Accounts maintained with one or more Depository or Custodial Institutions, or where the asset is an Equity Interest in a regulated Investment Entity that, for regulatory or other legal reasons, can only be registered and

transferred through the Investment Entity by traditional means or a distributed ledger controlled by the issuing Investment Entity or its agent or both. In such cases, the optional provision under Section I(G) of the amended CRS is not applicable.

Conversely, where the above conditions are not met, a digitally issued or tokenised Financial Asset qualifies as a Crypto-Asset under Section IV(A)(1) of the CARF and Section VIII(A)(12) of the amended CRS and the optional provision under Section I(G) of the amended CRS can be applied.

The above guidance does not seem to be sufficient to ascertain whether the tokenized traditional financial assets can be treated as not Crypto-Assets and may not be practical for daily use. It would require further clarifications with practical examples.

a) Certain Financial Assets may be tokenized for the purposes of internal recordkeeping, accounting, reporting, and other back-office functions. The Financial Institution will continue to record ownership of the Financial Asset via a conventional book entry system and report upon the relevant Account Holder under the CRS. In this instance, the tokens do not have inherent value separate from the Financial Asset they represent and the use of distributed ledger technology in this manner merely amounts to *"a declarative record of the underlying position or ownership of assets represented by such record"*. As a result, such tokens should not be treated as Crypto-Assets subject to dual reporting also under the CARF.

   We suggest specifying in the guidance / FAQ that the use of blockchain or Distributed Ledger Technology ("DLT") based systems for maintaining books and records of Financial Assets which serve the identical functional purpose as electronic book entries that are used to record assets in traditional electronic systems does not result in the reclassification of such assets as crypto-assets under CARF. Similarly, the corresponding entry in the Custodial Account is not itself a "a digital representation of value that relies on a cryptographically secured distributed ledger to validate and secure transactions" because DLT-based books and records system that records the underlying position or ownership of an asset does not have intrinsic value.

b) There might be cases of partial use of traditional channels and partial use of decentralized manner for holding and transferring assets or cases where initially the assets were out of scope for CARF and later fell in scope of CARF. In such cases, clear guidance should be provided for practical usage including whether the determination should be done at a product or account level.

   For example, a custodial institution that holds the tokens for customers could be in a position of not being initially in scope (while the token is limited to traditional financial accounts), but if later the token provider makes it available for trading on blockchain outside of custody accounts, then that would bring the custodial institution into scope of CARF.

c) For blockchain, the guidance appears to confuse two different concepts – a token may "live"

on a decentralised blockchain, where the blockchain is validated in a decentralised way, but it does not mean that the token 's holdings or transfers cannot be controlled by a single entity (custodial institution). So the statement that "*the definition of Crypto-Assets targets those assets that can be held and transferred in a decentralised manner"* is confusing and will import this confusion to the treatment of tokenized assets. For securities tokens, the guidance needs to say tokens that are legally and regulatory equivalent to a CRS Financial asset, instead of referring to equity interests.

d) We propose that those assets which fall within the definition of financial assets as per existing CRS should be carved out from CARF.

Scope of application for Specified Electronic Money Product

4. Under FAQ 4.7 of OECD CARF, in determining whether a specific product qualifies as a Specified Electronic Money Product in respect of the condition set out in Section IV(A)(4)(e) of the CARF and Section VIII(A)(9)(e) of the amended CRS, a Reporting Crypto-Asset Service Provider may rely on the relevant regulatory authorisations or approvals granted in respect of that product. In this regard, we recommend the IRD to make reference to Stablecoins Ordinance and specify that those stablecoins meeting the Stablecoins Ordinance definition will meet the Specified Electronic Money Product definition under amended CRS.

5. Under FAQ 4.8 of OECD CARF, jurisdictions may specify that RCASPs and RFIs are allowed to treat a product as either a Relevant Crypto-Asset or a SEMP for all or part of the calendar year or other appropriate reporting period in which such product becomes a SEMP. We recommend that the IRD follows the same approach as laid out by OECD in the FAQ, i.e., to treat the product as a Relevant Crypto-Asset until the date on which the definitional requirements of SEMP are met and thereafter, the product should be excluded from CARF and be covered under amended CRS.

6. A new category of excluded account is added in the amended CRS to exempt low-risk digital money products given the limited monetary value stored, namely SEMPs whose rolling average 90-day end-of-day account balance or value does not exceed USD10,000 in any consecutive 90-day period.

   We would recommend operational clarification on how SEMP requirements apply in conjunction with the low-value threshold. Specifically, where a product qualifies as a SEMP but is treated as a low-value excluded account, it should be clarified whether the SEMP due diligence still applies notwithstanding the absence of a reporting requirement.

Reporting requirements

7. One of the reporting requirements under CARF on a transaction level basis is the aggregate fair market value, as well as the aggregate number of units in respect of transfers by the reportable user executed by the RCASP to wallet addresses not known by the RCASP to be associated with a

virtual asset service provider ("VASP") or FI.

Clear guidance and suggestions would be recommended as to what the expectations from the RCASP would be to ascertain whether the receiving wallet address is associated with a VASP / FI or not.

8. One of the additional reporting requirements under amended CRS is to indicate whether the account is a pre-existing or a new account. There is a specific declaration in Part 3 of the Hong Kong CRS Financial Account Information (BIR 80) as to whether the RFI treats the subsequent accounts opened by pre-existing accounts as pre-existing accounts as allowed under the expanded definition of pre-existing account.

   Certain RFIs' current systems may only capture the Account Opening Date or the date the customer relationship commenced and may not have an indicator as to whether a subsequent account onboarded was classified as pre-existing under the expanded definition of pre-existing account (certain subsequent accounts of pre-existing customers may be classified as Pre-existing Accounts and be subject to Pre-existing Account due diligence provided certain conditions are satisfied). This limitation could result in unintended reporting inaccuracies, notwithstanding that the applicable due diligence standards are applied in accordance with CRS requirements. This approach inadvertently introduces complexity into how this new field should be reported, and guidance in this regard would be recommended. For example, either of the following approaches should be acceptable to deduce whether the account is pre-existing or new account for the purposes of the additional reporting requirement under the amended CRS:

   - Utilise the Account Opening Date for every account to determine if the account is pre-existing or new (this approach is operationally easier)
   - Utilize the earliest Account Opening Date at customer level to ascertain if the customer is pre-existing or new to the RFI, applying that same flag to all accounts held by that customer (assuming that all conditions are met for the new accounts to be treated as pre-existing accounts (IRD CRS Guidance Chapter 8, para 29)).

Due diligence procedures

9. Under CARF, where the self-certifications are not obtained within 12 months when it comes to pre-existing accounts, the regulation should suggest what would be sufficient to discharge the RCASPs due diligence responsibilities in this case.

10. Given that US also participates in CARF, OECD makes references in their commentary to allow RCASPs to place reliance on FATCA due diligence procedures. We would suggest similar references also be made in the Hong Kong regulations to cover US users, in particular, under FATCA there is a different set of US indicia and curing procedures for due diligence purposes.

11. Given that CARF would be implemented before the amended CRS for Hong Kong, we recommend

that the due diligence procedures performed under CARF be relied upon later on under amended CRS. We request the legislation to consider allowing this, else it would result in going back to the investor twice for the same information for CARF and CRS.

12. Also, a question arises as to whether reporting under CARF may lead to reporting under amended CRS for those accounts which are below the threshold limits available under CRS (e.g., the HKD1.95M threshold for pre-existing entity accounts) but not for CARF. We suggest that the legislation should allow them to continue placing reliance on the thresholds under CRS irrespective of the reporting under CARF.

13. One of the additional requirements in respect of account holders' reporting is whether a valid self-certification has been obtained for each account holder and/or controlling person who is a reportable person.

    There will be legitimate situations where New Accounts do not hold a valid self-certification, for example, when an Account Holder experiences a change in circumstances and has not yet provided an updated self-certification. As the enhanced reporting requirements or amended CRS XML may not clearly capture this scenario, it is important to ensure that the reported data is not misinterpreted by the IRD as a failure by the RFI to carry out the necessary due diligence procedures for New Accounts.

14. The legislation should clarify specifically as to whether valid self-certification constitutes only completeness of the form or even confirmation on the reasonableness of the form when it comes to the new reporting requirement of the validity of self-certification forms under CARF or amended CRS.

15. An excluded person under CARF includes an FI other than an investment entity described in subparagraph E(5)(b) of Section IV of the CARF Rules (professionally managed entities). The objective or reason to not exclude Type B investment entities (professionally managed entities) does not seem to be clear, which is a material variation from CRS. This would lead to unnecessary burden in the asset management industry for reporting unnecessary information of the funds by the fund managers as RCASPs. We recommend excluding all Financial Institutions similar to CRS.

    For example, in case of separately managed accounts ("SMA") / mandate accounts, asset managers execute trades with brokers via agency agreements (i.e. the broker doesn't contract directly with the underlying asset manager client) and where the asset manager invests into crypto assets under the mandate, it could be conceived that the asset manager is considered to effectuate crypto transaction for mandate clients. Effectively the asset manager could be considered to be an RCASP with the end client being the user. As such, these SMA / mandate accounts to the extent that they are maintained by entities would be reported and covered by both, CARF and amended CRS.

16. Tie-Breaker Rule - Clear guidance should be provided regarding the due diligence obligations of

RFIs with respect to previously opened and CRS 2.0 accounts.

a) Propose no obligation to review accounts opened prior to introduction of the new rule as account holders do not generally provide details of how they determine their tax residency and RFIs are unlikely to be aware (or, if aware, to have systematically stored in a readily retrievable manner) if a tie-breaker rule was applied.
b) Information regarding the application / non-application of tie-breaker provisions should be provided on the OECD website alongside information relating to individual country tax residence rules. RFIs should not be required / expected to provide guidance to account holders on this topic.

17. In respect of TIN, an RCASP / RFI will have a reason to know that a self-certification is unreliable or incorrect if the self-certification does not contain a TIN which does not align with the OECD TIN guidance. We noticed that often there's exceptional cases which the current OECD TIN guidance does not cover.

- Example 1: asylum seekers in Hong Kong may meet the definition by way of physical presence under the Hong Kong tax resident definition and may have basic banking needs. However, the Immigration Department in Hong Kong currently does not issue TIN to asylum seekers.
- Example 2: Certain offshore holding companies e.g. BVI-incorporated entities, whose central management and control is exercised in Hong Kong e.g. the directors are based in Hong Kong. While such entities may regard themselves as Hong Kong tax residents under the "management and control" test, in practice they may not be required or able to obtain a Hong Kong Business Registration Number, and therefore may not have a Hong Kong TIN. In these circumstances, it would be helpful to clarify whether a self-certification indicating Hong Kong tax residence with a 'Reason B' explanation would be regarded as acceptable.
- Example 3: A customer at the time of account onboarding provided a valid self-certification indicating tax residence in the People's Republic of China. Subsequently, the customer updated the account information by changing the address to Hong Kong address and provided a Hong Kong Identity Card Number, together with a new self-certification declaring Hong Kong as sole tax residence. In this regard, it would be helpful to clarify whether a RCASP is required to obtain further explanation and/or documentation from the customer.

Therefore, we suggest the legislation reflects the need for additional guidance to the OECD on TIN guidance.

Treatment of qualified non-profit entities

18. The amended CRS contains a new optional NRFI category of "qualified non-profit entity", for any genuine non-profit entity that meets all of the specified conditions. Only entities that have obtained a recognition of tax exemption status under section 88 of IRO (i.e. tax-exempt charities) may be considered as qualified non-profit entities. The Consultation Paper also states that a tax-exempt charity must demonstrate to IRD that all the specified conditions are met before the tax-

exempt charity can be treated as a qualified non-profit entity and, in turn, an NRFI.

We would like to seek guidance with respect to any additional due diligence obligations or reasonableness test imposed on RFIs to ascertain the "qualified non-profit entities" classification. We recommend that the legislations clarify that the RFIs can solely rely on public information such as list of charitable institutions and trusts of a public character under S88 of IRO.

Data protection principles

19. We understand that when carrying out the reporting and due diligence requirements, RCASPs should comply with the existing requirements under the data protection principles in Schedule 1 to the Personal Data (Privacy) Ordinance (Cap. 486). We seek your suggestion on the method of such notification to the customer, i.e., is there any specific manner required under CARF or can the customers be notified by relevant terms and conditions in RCASP's normal course of business. We suggest that the RCASPs can notify the customers by relevant terms and conditions in their normal course of business.

20. Please confirm if Crypto-asset users and controlling persons are entitled to request access to the information related to reporting data, e.g. market value and exchange rate used to furnish the reporting.

21. In certain cases, accounts could be maintained in a particular jurisdiction but the reporting may happen in a different jurisdiction due to, for example, the nexus conditions. In such scenarios, where there are data restrictions between the jurisdictions, the legislation should provide for overcoming such data restrictions.

Definitions:

22. Hong Kong definition of RCASP has replaced the word *"effectuating"* with *"executing"*. We would suggest that it is aligned with the OECD definition or otherwise clarified whether this would have any implication and intent to scope certain activities out for an RCASP as compared to the OECD version.

23. In accordance with the OECD amendments to the CRS commentary ("Commentary on Section VIII concerning Defined Terms, paragraph 16"), please confirm that the legislation will adopt the approach whereby collective investment schemes are classified as an entity that primarily conducts as its business one or more of the following activities or operations for its customers—

(i) trading in—
(A) money market instruments, including cheques, bills, certificates of deposit, and derivatives;
(B) foreign exchange;
(C) exchange, interest rate and index instruments;
(D) transferable securities; or

(E) commodity futures;

(ii) individual and collective portfolio management;

(iii) otherwise investing, administering, or managing financial assets or money on behalf of other entity or individual.