



HAN KUN LAW OFFICES

Legal Commentary



CHINA PRACTICE • GLOBAL VISION

February 23, 2018

Banking & Finance Law

Detailed Rules for Chinese CRS Arrived, but Are Banks Ready?

– Interpreting the Detailed Rules of Due Diligence on Non-Residents' Financial Accounts of Deposit-taking Banking Financial Institutions for Tax Purpose

TieCheng YANG | Yin GE | Bing XUE | Michael KAN

On 18 December 2017, the People's Bank of China, the State Administration of Taxation and the State Administration of Foreign Exchange jointly issued *Detailed Rules for Due Diligence on Taxation-related Information of Non-Residents' Financial Accounts at Deposit-taking Banking Financial Institutions* ("**Detailed Rules**"),¹ and the People's Bank of China published the Rules on its website on 29 December 2017.

The Rules provide detailed operating guidelines for Chinese deposit-taking banking financial institutions ("**banks**") to conduct due diligence on tax-related information of financial accounts held by non-residents in China. In accordance with the Detailed Rules, banks are required to collect tax-related information of non-residents and report such information to the competent authorities.

Background

On 19 May 2017, the State Administration of Taxation, together with the Ministry of Finance, People's Bank of China, China Banking Regulatory Commission, China Securities Regulatory Commission and China Insurance Regulatory Commission formally promulgated the *Regulation of Due Diligence on Financial Accounts of Non-Residents for Tax Purpose* (the

¹ 《银行业存款类金融机构非居民金融账户涉税信息尽职调查细则》 [Detailed Rules for Due Diligence on Taxation-related Information of Non-Residents' Financial Accounts at Deposit-taking Banking Financial Institutions] (People's Bank of China, St. Admin. of Taxation, St. Admin. of For. Exch., Yin Fa [2017] No. 278; issued 18 Dec. 2017).

"Regulation") which came into effect on 1 July 2017.² This indicates that the Chinese version of the Common Reporting Standard ("CRS") is finally taking root in China, with an aim to adapt the internationally applicable CRS into specific requirements in line with national conditions in China, and to provide a legal basis and operating guidelines for China to implement CRS.

The Regulation requires "financial institutions established in the People's Republic of China" to be responsible for conducting due diligence on the tax-related information of financial accounts held by non-residents, and prescribes that "financial institutions" includes depository institutions, custodial institutions, investment entities, specified insurance institutions and their branches. Moreover, the Regulation clarifies that private equity investment funds, private equity fund management companies and partnerships engaging in private equity fund management business are all listed as within the scope of financial institutions (for detailed background information, refer to *Analysis of Private Equity Fund Managers' Due Diligence Obligations under the Chinese Version of CRS* (《私募基金管理人在中国版 CRS 下的尽职调查义务解析》)).

Key Contents of the Detailed Rules

The Detailed Rules provide specific guidance to banks on how they should fulfill their due diligence obligations under the Regulation with respect to common types of banking business and account management methods. Compared to the Regulation, the Detailed Rules are more capable of being implemented in practice.

I. Which accounts are subject to due diligence?

In line with CRS requirements, the Regulation simply divides accounts subject to due diligence into three broad categories: depository accounts, custodial accounts and other accounts; each category is provided with examples for clarification. However, it will be a substantial challenge to determine account categories under the Regulation for banks that engage in a variety of financial services and hold different types of accounts.

In order to address this issue, the Detailed Rules clarify that banks will conduct due diligence on the following ten types of accounts opened while handling the relevant banking services based on the major types of services that banks presently undertake:

- (1) demand deposits;
- (2) time deposits;
- (3) pre-paid credit card services
- (4) security deposit services;

² 《非居民金融账户涉税信息尽职调查管理办法》 [Regulation of Due Diligence on Financial Accounts of Non-Residents for Tax Purpose] (St. Admin of Taxation, Min. of Finance, People's Bank of China, China Banking Reg. Comm., China Sec. Reg. Comm., China Ins. Reg., Comm., Announcement of the St. Admin of Taxation [2017] No. 14; promulgated 19 May 2017, effective 1 July 2017).

- (5) self-operated wealth management services;
- (6) precious metals account services;
- (7) national bonds services;
- (8) financial derivatives services;
- (9) other financial asset services which are initiated, established or managed by banks;
- (10) other services prescribed by the Regulation.

The foregoing services (1) - (9) are the major services that banks currently undertake, among which precious metals account services do not include the handling of physical precious metals. Therefore, banks do not need to conduct due diligence on accounts of customers that handle physical precious metals.

II. What is the scope of "financial asset management companies" ("FAMCs")?

Article 8 of the Regulation excludes FAMCs from the scope of financial institutions. Many institutions indicated that the definition of "FAMCs" is unclear, and deviations may occur at the time of determining FAMC status.

FAMCs are more clearly defined in Article 8 of the Detailed Rules, which provides that FAMCs only refer to financial asset management companies established under the "*Regulations on Financial Asset Management Companies* (《金融资产管理公司条例》)", which presently means the "Big Four" asset management companies in the traditional sense, and which does not include local FAMCs established by the way of filing with the China Banking Regulatory Commission ("**CBRC**").

III. How to classify the accounts which are re-opened after being closed?

Article 15 of the Regulation defines the terms of "pre-existing accounts" and "new accounts," but remains unclear as to accounts that are re-opened after having been closed.

Article 13 of the Detailed Rules gives an explanation of this circumstance and states that a customer who had closed all accounts at a bank on or before 30 June 2017 and re-opened a financial account at the same bank on or after 1 July 2017 will be treated as a new customer and will be required to complete the relevant declaration documents, even if the bank still possesses the customer's information after the accounts were closed. Any financial accounts re-opened in this manner will be classified as new accounts.

IV. What kind of "supporting materials" should a customer provide to prove his/her identity as a Chinese tax resident?

The Regulation at Article 18 provides only a rather ambiguous description of the supporting materials to be provided to prove Chinese tax resident status. Banks may therefore encounter

difficulty in practice when requiring customers to provide the appropriate supporting materials.

To this end, Article 15 of the Detailed Rules refines this description and clarifies that relevant supporting materials include:

- (1) the Certificate of China Tax Resident Status issued by tax authorities to an organization or individual;
- (2) Resident Identity Card of the People's Republic of China;
- (3) Foreign Permanent Resident Identity Card;
- (4) Evidence that an individual has actually lived in China for more than a year, such as the entry/exit records in his or her passport; and
- (5) Other valid materials.

The above tax authorities include the state taxation bureaus and local taxation bureaus, but the authority to issue Chinese tax resident identity certificates is made in reference to actual local circumstances. It should be noted that the supporting materials only refer to that which proves a customer with non-resident indicia as a Chinese tax resident, meanwhile materials issued by foreign authorities are excluded. If the customer has already claimed his/her status as a non-resident, the bank is only required to have the customer directly file the declaration document.

V. The period requirements of obtaining declaration documents for accounts pending activation

The Regulation stipulates that banks are required to obtain declaration documents from customers at the time of opening an account for new accounts opened after 1 July 2017. However, for an account which requires activation to be put in use, is it feasible to obtain the customer's declaration documents at the time of activation so that the bank can conduct its business more conveniently? In this regard, Article 18 of the Detailed Rules stipulates that: "for a bank account opened by an organization on behalf of an individual, which can only be used to receive deposits and not to make payments, the bank shall obtain a declaration document from the account holder at the time of opening; for accounts which can neither receive deposits nor make payments before activation such as credit card accounts, the bank shall obtain a declaration document from the account holder before activation..."

Why is a different approach taken for accounts pending activation? The reason is that a credit card account cannot be used before activation, i.e. the account cannot receive deposits or make payments before activation, which is essentially a "dormant account." Therefore, the bank can choose to conduct due diligence on the account holder when such account is officially put into use. By contrast, for accounts opened by organizations on behalf of individuals (e.g., wage card services), these accounts, in general, can receive deposits but cannot make

payments before activation, and once a certain amount of money is deposited into these accounts, there would be time difference in information reporting if the relevant declaration documents cannot be obtained timely. For example, in November 2017, a wage account for Country-A tax resident (X) was opened with a bank and wages were deposited into that account since December 2017. Compliance risk exists in that X's financial information would be omitted by the bank when it reports to the State Administration of Taxation at the designated time, 31 May 2018, as X had not signed a declaration document. In Hong Kong, the competent authorities also closely scrutinize accounts opened without complete materials that can only receive deposits and cannot make payments, since they suspect such accounts may be used for money laundering. Hong Kong banks are required to ask for the remaining documents from account holders within three (3) months. Failure to timely submit the required documents may result in closure of the account upon consideration of the relevant circumstances.

VI. How to determine whether there are any discrepancies in the declaration documents provided by the customer?

Articles 19 and 25 of the Regulation require financial institutions to determine whether there are any discrepancies between the information stated in the declaration documents and other materials, but the criteria for making the determination are not clearly defined. In order to facilitate the banks' implementation of the Regulation in practice, Articles 19 and 24 of the Detailed Rules provide certain judgment criteria. However, it should be noted that if an individual holding a Chinese identity card declares that he/she is a non-resident when opening an account, this should not be considered an obvious contradiction. The bank is only required to record and report the relevant information based on the declaration documents submitted.

VII. Declaration document requirements for entity accounts

The Regulation only prescribes that declaration documents are also required when opening an entity account, but remains silent as to the formatting requirements for the signature on the declaration document provided by the institution. In order to maintain consistency with the existing entity account opening procedures, Article 23 of the Detailed Rules prescribes that an official seal is required in addition to the signature of an authorized person of the institution. If relevant business is handled by an authorized person, the corresponding power of attorney shall also be provided. Certain overseas institutions that do not have an official seal can submit declaration documents with the signature or personal stamp of an authorized representative.

VIII. Newly-added exempted accounts

Compared with the Regulation, Article 33 of the Detailed Rules additionally provides that the accounts opened for the purpose of registered capital verification can be exempted from due diligence obligations, mainly because this type of account is a temporary transitional account, and the ownership of funds in this account is difficult to confirm within specified period, as the

funds neither belong to an individual, nor a company (not yet established).

In addition, the Detailed Rules clarify the definition of "exempted accounts." Take a tax-payment account as an example. If Company A specially opens a payment account for the purpose of making tax payments, the account can be exempt from due diligence so long as all account fund inflows and outflows are only to make tax payments. However, if Company A uses this account to pay for products, or receive any payments, the account would no longer fall within the scope of the exemption, and the bank would be required to conduct due diligence on the account.

IX. Issues requiring attention

Although the Detailed Rules provide more clear guidance for banks to a certain extent, and substantially reduce the workload of banks, the Detailed Rules cannot cover all of the potential issues, and banks should in practice continue to pay attention to the following:

(1) Types of accounts subject to due diligence

Although the Detailed Rules has clarified the account types subject to due diligence, the types of services offered by different banks and the corresponding types of accounts are not entirely the same as provided in the Detailed Rules. In such case, if a bank finds any other types of services similar in nature to those listed in the Detailed Rules, the bank should conduct due diligence on the relevant accounts in light of the Regulation and the Detailed Rules. Banks should be prudent in determining whether the relevant services meet the requirements of the Regulation and the Detailed Rules, since different banks may reach different conclusions based on different judgment criteria.

(2) System adjustments

The Detailed Rules impose certain requirements on banks' systems. Each bank must adjust its business procedures accordingly based on their actual circumstances, such as adding procedures for taxpayer identity information, identifying passive non-financial entities, controlling person information, etc. In addition, if a bank's business systems are not yet able to properly consolidate customer assets, care should be exercised so as to avoid duplications or omissions when reporting customer asset information.

(3) Understanding the scale of "due diligence" obligations

According to the requirements in the Regulation and the Detailed Rules, banks must have completed the due diligence procedures for pre-existing high-value individual customers (whose aggregate account balances exceed US\$1,000,000) before 31 December 2017, and for pre-existing customers other than high-value customers, the due diligence reviews must be completed before 31 December 2018. Currently, some banks have published corresponding announcements on their official websites

requiring their customers to co-operate and fulfill the relevant obligations. For banks, this is a relatively safe practice which means that they have already notified customers to submit the declaration documents according to the provisions in the Regulation. Even if the customer does not co-operate, banks have fulfilled their notification obligation.

As provided in the Regulation, banks are only required to have pre-existing customers with non-resident indicia in the bank's systems submit declaration documents, rather than all customers. Banks are likely to be able to contact customers whose account balances exceed US\$1,000,000, as these are key customers. Thus, for these customers, banks should consider notification by telephone or messaging them through their dedicated client managers for co-operation, which will guarantee a certain degree of privacy and also improve the customer experience.

(4) Due diligence on the pre-existing institutional customers

According to the Regulation and the Detailed Rules, banks must identify whether an existing institutional customer is a non-resident enterprise or a passive non-financial institution based on existing customer information, public information, etc. However, it may be difficult for a bank to determine whether the institution is a passive non-financial institution. In general, most institutional customers do not provide their financial statements when opening an account, and it is difficult to determine whether an institution is a passive non-financial institution solely based on its business scope. Therefore, when banks are unable to make a determination, they can only require the customer re-submit declaration documents for confirmation, which imposes heavy workload and is a substantial challenge for banks.

(5) The duty to conduct due diligence on banking products offered on behalf of other financial institutions

Article 30 of the Detailed Rules only prescribes that banks must co-operate with other financial institutions to conduct due diligence on funds and other financial products sold on a commissioned basis. However, the Detailed Rules do not specify how the parties are to co-operate in conducting the due diligence. Thus, it will be a critical issue to divide the due diligence duties between banks and the other financial institutions.

(6) Non-compliance risks for financial institutions other than banks

The Detailed Rules only refine the work required of banks, but remain silent as to other financial institutions, such as securities institutions, funds, trusts, private equity funds, etc. Although these financial institutions do not maintain as large a customer base as banks and handle relatively less business, their understanding of their customers may also be relatively low and not be as deep as that of banks. Therefore, such institutions

may be at risk of non-compliance if they do not refine their due diligence procedures.

In addition, when the above-mentioned financial institutions sell their financial products on third-party platforms other than through banks, the relevant account opening materials are generally transferred from the third-party platforms to the financial institutions. However, it is understood that third-party platforms have not begun implementing due diligence procedures yet, and thus it is uncertain whether the financial institutions can obtain customer declaration documents from the third-party platforms. According to the provisions of the Regulation, financial institutions are allowed to appoint third-party platforms to conduct due diligence and to obtain customer declaration documents. However, there could be a great risk of non-compliance if the financial institutions failed to request the third-party platforms to fulfill their due diligence obligations and obtain customers' declaration documents after 1 July 2017.

(7) Applicability of the Regulation on third-party payment institutions ("**TPIs**")

TPI accounts can also receive a certain amount of deposits. However, we understand that TPIs have not yet implemented due diligence checks in accordance with the Regulation. Article 7 of the Regulation provides for a miscellaneous clause that includes other institutions satisfying certain conditions in the definition of "financial institution" under the Regulation. Thus, it remains uncertain whether TPIs are within the scope of financial institutions as prescribed by the Regulation. If TPI account balances continue to increase, it is likely that the regulatory authorities will incorporate TPIs into the regulatory scope of the Regulation in the near future.

● **Important Notice**

This Legal Commentary has been prepared for clients and professional associates of Han Kun Law Offices. Whilst every effort has been made to ensure accuracy, no responsibility can be accepted for errors and omissions, however caused. The information contained in this publication should not be relied on as legal advice and should not be regarded as a substitute for detailed advice in individual cases.

If you have any questions regarding this publication, please contact **Mr. TieCheng YANG (86 10 85164286; tiecheng.yang@hankunlaw.com)** or **Ms. Yin GE (8621-60800966; yin.ge@hankunlaw.com)**.