Hong Kong AEOI Updates

The digital asset market in Hong Kong and the requirements on global tax transparencies

20 December 2024

Paul Ho, Partner, Ernst & Young Tax Services Limited, EY Asia-Pacific Financial Services Business Tax Services Leader

Francis Tang, Partner, Financial Services Tax, Customer Tax Operations and Reporting Services, Ernst & Young Tax Services Limited

Dalvir Sohanpal, Director, Financial Services Tax, Tax Technology & Transformation, Ernst & Young Tax Services Limited

Hilton Kwok, Manager, Financial Services Tax, Customer Tax Operations and Reporting Services, Ernst & Young Tax Services Limited

Introduction

In light of market demand and to facilitate market development, the Securities and Futures Commission of Hong Kong (SFC) has introduced a number of crypto-related regulations and guidance in the past couple of years.

In June 2023, the new licensing regime for centralised Virtual Asset Trading Platforms (VATPs) under the Anti-Money Laundering and Counter-Terrorist Financing Ordinance (Cap. 615) came into effect[1]. Crypto exchanges carrying on businesses in Hong Kong, or actively marketing their services to Hong Kong investors, must be licensed and regulated by the SFC. Several VATP operator applicants have submitted their applications and are now deemed-to-be-licensed VATPs awaiting to be formally approved to be licenced by the SFC.

In November of the same year, in view of Hong Kong financial institutions' growing interest in tokenising traditional financial assets, the SFC also provided guidance on tokenised securities-related activities, clarifying the regulatory expectations for intermediaries engaged in such activities[2].

One year later in December 2024, the Hong Kong Government published in the Gazette the Stablecoins Bill[3], which aims to put in place a regulatory regime for issuers of fiat-

---

[1] *Circular on implementation of new licensing regime for virtual asset trading platforms*, 31 May 2023, https://apps.sfc.hk/edistributionWeb/api/circular/openFile?lang=EN&refNo=23EC28

[2] *Circular on intermediaries engaging in tokenised securities-related activities*, 2 November 2023, https://apps.sfc.hk/edistributionWeb/api/circular/list-content/circular/doc?refNo=23EC52&lang=EN

[3] *Gazettal of Stablecoins Bill*, 6 December 2024, https://www.info.gov.hk/gia/general/202412/06/P2024120500406.htm

referenced stablecoins (FRS) in Hong Kong. The proposed regulatory regime is suggestive of an increasingly robust stablecoin ecosystem in Hong Kong and thus more parties are likely to be utilizing/holding stablecoins soon.

As we see an increase in crypto-related activities in Hong Kong, intermediaries should also observe the upcoming global tax transparency regulations issued by the Organisation for Economic Co-operation and Development (OECD). Such regulations should soon be localised into domestic legislations by 2026 since Hong Kong has confirmed its commitment to implement Crypto-Asset Reporting Framework (CARF) on a reciprocal basis with appropriate partners that meet the required standards for protecting data confidentiality and security. Based on the latest timetable set by the Global Forum, the Hong Kong Government aims to commence the first automatic exchanges with relevant jurisdictions under CARF from 2028.

Back in 2023, the OECD published the "*International Standards for Automatic Exchange of Information in Tax Matters: Crypto-Asset Reporting Framework and 2023 update to the Common Reporting Standard*", and there are two parts to this publication:

- Crypto-Asset Reporting Framework (CARF)
- Update to the Common Reporting Standard (CRS)

Crypto-Asset Reporting Framework (CARF)

CARF is a newly introduced regime to place reporting obligations on "Reporting Crypto-Asset Service Providers", which are intermediaries and other service providers effectuating transactions in crypto-assets for or on behalf of customers.

The aggregated transaction value of acquisition and disposal of crypto-assets against fiat currency would have to be reported under the CARF.

On 2 October 2024, the OECD published the CARF XML Schema, which reflects how the different categories of Relevant Transactions would be reported. Whilst the skeleton of the CARF schema looks similar to the existing CRS schema that most Financial Institutions are familiar with, it can be expected that the reporting volume would be significantly larger than under the CRS. This is because the CRS does not require reporting by asset type (e.g., bonds and equities are reported as a single balance) whereas the CARF would require reporting by the type of crypto-asset (e.g., Bitcoin, Ethereum) and based on transaction types.

Update to the CRS

Amidst other updates, the definition of "Financial Assets" has been expanded to include "Relevant Crypto Assets". New digital financial products are also soon to be covered under the CRS, namely Specified Electronic Money Products and Central Bank Digital Currencies.

The section outlining updates to the CRS in the *Crypto-Asset Reporting Framework and 2023 update to the Common Reporting Standard* has also pointed out that:

> *"…the definition of Investment Entity does not currently contain Crypto-Assets as a category of eligible investments that would bring the Entity in scope of the CRS, as the definition presently only encompasses Financial Assets and money. The definition of Investment Entity is therefore expanded to include the activity of investing in Crypto-Assets."*

This clarification is critical as intermediaries which previously treat crypto-assets as in-scope of the CRS should now re-evaluate their positions. It is clear that the OECD, through amendments to CRS, brings crypto-assets within the scope of the CRS and is also introducing the CARF to provide regulations on crypto activities. In other words, crypto-assets should not be within scope of the CRS before the enactment of the CRS amendments.

Hong Kong's participation in CARF

According to the *Tax Transparency in Asia 2024: Asia Initiative Progress Report, Global Forum on Transparency and Exchange of Information for Tax Purposes* published by the OECD, Hong Kong is one of the seven Asian jurisdictions that has joined the CARF Group constituted by the Global Forum. The CARF Group is entrusted with discussing technical issues relevant to supporting the implementation of the CARF as well as to ensure the widespread implementation of the CARF.

Given Hong Kong's active participation in the early stages of CARF's introduction and it has also informed the Global Forum on Transparency and Exchange for Tax Purposes (Global Forum) of the OECD on 13 December 2024 of its commitment to implement CARF, alongside 63 other jurisdictions that has also signed the Multilateral Competent Authority Agreement (MCAA), we can expect that CARF regulations will be put in place in Hong Kong by 2026 and first exchange is expected to commence in 2028.

Observations of the impacts of CARF and the amended CRS on key market players in Hong Kong

Three major business sectors in Hong Kong may need to look into their CRS due diligence and/or reporting obligations prior to the implementation of CARF and the amended CRS, whilst preparing for the two new regimes.

	Prior to implementation of amended CRS and CARF	**Upon implementation of amended CRS and CARF**
(1) VATPs and crypto wallets	VATPs and crypto wallets which previously treated crypto-assets as CRS in-scope products should reconsider their positions, as it has now been clarified that crypto-assets are not within the ambit of the CRS. Amended CRS returns may have to be submitted to remediate any over-reporting.	Once the new regimes are implemented, certain crypto-assets become in-scope under both regimes. VATPs and crypto wallets should evaluate their due diligence and reporting obligations under the two regimes.
(2) Funds investing in crypto-assets	Funds that invest in crypto-assets should re-evaluate their entity classification as Financial Institutions given that crypto-assets did not qualify as Financial Assets.	Upon the implementation of the amended CRS and CARF, certain crypto-assets become in-scope products. Funds that invest in crypto-assets should then consider if they qualify

	Any CRS returns previously submitted may have to be amended/voided to remediate any over-reporting.	as Financial Institutions under the amended CRS. They should evaluate their due diligence and reporting obligations under the regimes.
(3) Tokenization of traditional fund units	A fund token (cryptography-based token) is not a Financial Asset under the current CRS. A token custodian accordingly may currently not qualify as a Financial Institution. Funds, being the Financial Institutions, may have the obligations to perform due diligence and reporting on the individuals or entities who are the beneficial owners of the fund units held via the token custodian with a view of the definition of "account holders" under the CRS. The Funds should have sufficient processes with the token custodians such that the Funds are also informed of newly onboarded account holders, so that due diligence and reporting can be performed by the Funds or their delegates in an accurate and timely manner.	A token custodian may qualify as a Financial Institution when cryptography-based tokens become in-scope of the amended CRS and/or CARF. When this happens, the due diligence and reporting obligations may then vest with the token custodian, and the Fund should no longer be liable for the due diligence of these ultimate beneficial owners.

Upcoming actions/considerations for intermediaries or VATP

- Due diligence considerations
  - The review of existing onboarding systems and controls to ensure documents and data points are collected accurately for CRS and CARF purposes, reviewed for reasonableness through system controls, stored and extracted for reporting purposes. For VATPs there may be the need to further investigate whether additional capabilities such as digital form collection can be built into the existing client web or mobile wallet opening process.
  - Whilst considering changes in the onboarding systems, additional data points required under CRS and CARF for reporting should be introduced to ensure information is collected at the beginning of the process.
  - Offline methods of data and document collection (e.g., physical form population with limited control checks) to be moved towards digital channels, where considered to be cost-effective.

- Integration and reference data considerations
  - Customer tax reference data used as inputs into indicia checking and classification, (e.g., country codes, entity classifications, product classifications, roles of controlling persons or equity interest holders, etc.) should be reviewed

for completeness and clear ownership for ongoing maintenance established, if not already in place.
    - The review of existing onboarding and customer tax repository systems to streamline through digital integration, resulting in robust controls from a change driven event to obtaining a valid self-certification from client.
    - VATPs would not only have to rollout the above functionality but ensure controls to monitor client changes.

- Reporting
    - Existing financial institutions will need to update their automation extraction processes to cater to the changes in the CRS and CARF schemas, if applicable.
    - Given that CARF requires an aggregated transaction-level reporting, data collection at transactional level will now enter the picture. VATPs will need to establish system capabilities to bring together client profile and blockchain transactional data in relation to each wallet, to form the required dataset for CARF schema reporting purposes.
    - The need for transactional level data will increase the overall volume of data throughout the customer tax process, therefore performance impact (non-functional) to existing systems, analytics or extraction capabilities should be considered alongside other functional requirements with the relevant system owners.

Looking ahead

As the Secretary for Financial Services and the Treasury, Mr Christopher Hui said: "CARF is the latest global standard on tax transparency. Its implementation is crucial for maintaining Hong Kong's reputation as an international financial and business centre. It also reflects Hong Kong's ongoing efforts in promoting international tax co-operation as a responsible tax jurisdiction."[4]

The CARF and the updates to the CRS are fast approaching.

With Hong Kong's commitment to CARF on a reciprocal basis, we can expect new CRS and CARF regulations to be put in place in Hong Kong by 2026.

Local key market players dealing with crypto-assets directly or crypto-related products should act quickly to remediate any potential errors in prior years CRS reporting (e.g., over-reporting), and at the same time begin to enhance their IT infrastructure as well as other processes in preparation for large volume data storage and extraction for CARF reporting purposes.

Talk to us – EY Customer Tax Operations and Reporting Services (CTORS) Team based in Hong Kong - for your upcoming plan on CARF compliance and operational efficiencies.

---

[4] *Hong Kong commits to implementing Crypto-Asset Reporting Framework*, 13 December 2024, The Government of the Hong Kong Special Administrative Region Press Release, https://www.info.gov.hk/gia/general/202412/13/P2024121300491.htm

EY | Building a better working world

EY is building a better working world by creating new value for clients, people, society and the planet, while building trust in capital markets.

Enabled by data, AI and advanced technology, EY teams help clients shape the future with confidence and develop answers for the most pressing issues of today and tomorrow.

EY teams work across a full spectrum of services in assurance, consulting, tax, strategy and transactions. Fueled by sector insights, a globally connected, multidisciplinary network and diverse ecosystem partners, EY teams can provide services in more than 150 countries and territories.

All in to shape the future with confidence.

About EY's Tax services

Your business will only succeed if you build it on a strong foundation and grow it in a sustainable way. At EY, we believe that managing your tax obligations responsibly and proactively can make a critical difference. Our 50,000 talented tax professionals, in more than 150 countries, give you technical knowledge, business experience, consistency and an unwavering commitment to quality service — wherever you are and whatever tax services you need.

APAC no. 03021454

ED None.

ey.com/china