



STEP

Submission to the Legislative Committee by STEP Hong Kong Branch on the draft Inland Revenue (Amendment) (No. 3) Bill 2009

1. Purpose and background

The purpose of this note is to comment on the proposed amendments to the current tax legislation in Hong Kong as set out in the Inland Revenue (Amendment) (No. 3) Bill 2009 ('**HK Bill**'). The purpose of these amendments is to facilitate compliance with the exchange of information ('**EOI**') provisions to be introduced into the tax treaties that Hong Kong has already entered into and the new comprehensive double taxation agreements that Hong Kong will enter into in future ('**CDTA**').

Singapore also intends to make amendments to its tax legislation as set out in the Singapore Income Tax (Amendment) (Exchange of Information) Bill ('**Singapore Bill**') or a similar purpose.

In addition to commenting on the proposed Hong Kong legislation this note compares the amendments proposed by Singapore and Hong Kong. The purpose of this comparative analysis is to address the impact that the proposed changes to Hong Kong law may have for the competitiveness of the Hong Kong financial community when compared with Singapore.

Reference is made in this note to Legislative Council Brief (File Ref: FIN CR 12/2041/46) (the '**Brief**') produced by The Financial Services and the Treasury Bureau ('**FSTB**') on 24 June 2009 and the Paper for the House Committee Meeting on 10 July 2009 (the '**Paper**') produced by the Legal Service Division of Legislative Council ('**LegCo**') on 8 July 2009.

2. Proposed amendments

2.1 Purpose

In the explanatory memorandum of the HK Bill, it states that the purpose of is to 'facilitate the collection and disclosure of information' in relation to its obligations under the double taxation treaties. The Singapore Bill states that the purpose is to 'facilitate the exchange of information under certain avoidance of double taxation arrangements' and to make consequential amendments to relevant legislation. Both jurisdictions have to amend their domestic legislation to broaden information collection powers to comply with EOI requirements.

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2.2 Legislative approach

The HK Bill proposes to insert new sub-sections to existing sections of the Inland Revenue Ordinance ('IRO') and Personal Data (Privacy) Ordinance ('PDPO') to deal with the EOI provisions. The Singapore Bill proposes to introduce a new Part XXA to the Income Tax Act ('ITA') to deal with the EOI provisions and makes consequential amendments to the Goods and Services Act and the Stamp Duties Act.

The amendments to the Singapore legislation will specify the detailed requirements and conditions for obtaining information or providing it to a requesting party under EOI provisions. The amendments proposed in the HK Bill are merely enabling legislation and, unlike in Singapore, much of the detail will be dealt with at Administration level by subsidiary legislation and by production of an Inland Revenue Department ('IRD') Departmental Interpretation and Practice Note ('DIPN') setting out the procedural safeguards that IRD should observe in processing EOI requests.

2.3 Request for information

It is not stated in the HK Bill who has the authority to make a request for information. This is presumably because it is intended that more detailed particulars of the process will be established by subsidiary legislation and a DIPN. The request will be administered by the IRD.

The Singapore Bill proposes that the competent authority may make a request to the Comptroller for information. A competent authority is defined as a person whom the Comptroller believes has the authority to request for information under the EOI provision. The request has to contain the information set out in the Eighth Schedule of the Singapore Bill.

2.4 Obtaining information

Under sections 51(4) and 51(4A) of the IRO, wide powers are provided to the IRD to obtain information from a person with relevant information in relation to any person's liability, responsibility or obligations under the IRO. The HK Bill proposes to extend this power to obtain information in relation to the person's liability, responsibility or obligations under the laws of other jurisdictions that HK has EOI provisions with. It is also proposed that the power to apply to the magistrate for a search warrant and the magistrate's power to issue a warrant under section 51B is also extended to obtain information in relation to these of other jurisdictions.

Section 65 of the ITA provides the Comptroller with the power to give notice to a person to collect information in relation to any person's income and the Singapore Bill proposes to extend this to include the collection of information requested by a competent authority, including foreign tax authorities.

2.5 **Restricted information**

The Singapore Bill proposes that, where the information requested is protected by the Banking Act or the Trust Companies Act, it will be necessary to obtain a written authorisation from the Attorney-General to then apply to the High Court for an order to obtain the restricted information. There will be three conditions that have to be satisfied before the High Court allows access to the information. The first is that the order is justified in the circumstances; the second is that there are reasonable grounds for believing that the information is not subject to legal privilege, and the third is that it is not contrary to public interest to release the information. There is also a supplementary section, section 105J, which deals with orders issued by the High Court. Section 105J(4) states that an order 'shall not confer any right to the production of, or of access to, information subject to legal privilege.'

Unlike the Singapore Bill, the proposed HK Bill contains no like judicial safeguards. According to the LegCo Brief, prudent safeguards will be introduced by subsidiary legislation to protect an individual's right to privacy and confidentiality as summarised below:

(a) **Restrictions in terms of scope**

- Information will only be conducted on a case-specific basis, in response to legitimate requests. There will be no "wholesale exchange" of information.
- Only information on taxes covered by the CDTA will be exchanged.
- The requesting party must satisfy the IRD that the information requested is 'necessary' or 'foreseeably relevant'.

(b) **Restrictions in terms of usage**

- The requesting party must treat the information as secret information.
- The requesting party must not share the information with a third party (including a third jurisdiction) regardless of domestic disclosure laws.
- The requesting party must only use the information provided for the purposes specified in the request.

(c) **Restrictions imposed by domestic laws of the requesting party**

- The requested party is not obliged to supply information that they could not have under its own laws.

(d) **Domestic Safeguards**

A series of domestic safeguards will be introduced through subsidiary legislation. A set of safeguards will be set out under Section 49(6):

- The decision on whether to consent to an EOI request has to be made by a directorate officer of the IRD.
- In turn the IRD has to notify the person about whom the information is being sought (i.e. the impacted person) that is to be transmitted and provide such information to them.
- The impacted person can verify the accuracy of the information with the IRD, and if the IRD refuses to accept the proposed correction then the person can appeal to a higher authority (proposed to be the Financial Secretary), whose decision shall be final.

IRD will issue a 'Departmental Interpretation and Practice Note' setting out requirements that the requesting party should:

- Be the competent authority of the requesting state;
- Make the EOI request in writing;
- Confirm that it has pursued all means available in its own territory to obtain the information;
- Confirm that the request is in conformity with the laws and administrative practices of the requesting party; and that the requesting party could obtain the information if it were within its own jurisdiction;
- State grounds for believing that the information is in Hong Kong, or in the possession of a person in Hong Kong; and
- Provide specified background information, and reasons for the request.

It is difficult to comment on the proposals when no draft subsidiary legislation has been provided at this stage. It is also worth noting that a DIPN issued by the IRD is not legally binding.

We understand that the domestic safeguards to notify the impacted person, as set out in (d) above, only applies to persons residing in Hong Kong and does not extend to such persons outside of Hong Kong. It is difficult to understand the reasoning for this, despite what we understand the FSTB has said concerning this at para 2.7.

2.6 Legal professional privilege

The HK Bill has no additional provisions dealing with the safeguard of information that is subject to legal privilege. There is existing provision in section 51(4A) of the IRO to protect privileged information, which will apply to the powers of the IRD as expanded by the HK Bill. It should be noted that section 39A(2) of the Legal Practitioners Ordinance ('LPO') extends solicitor-client privilege to a 'foreign lawyer' and his client to the same extent as it exists between a Hong Kong solicitor and his client. However for this purpose a 'foreign lawyer' is a lawyer who has registered as such as permitted by section 39A(1) of the LPO. Therefore privilege is not extended under this legislation to a foreign lawyer who is not so registered. It follows that there is cause for concern that materials held in Hong Kong that represent legal advice of persons other than Hong Kong solicitors or registered foreign lawyers may not qualify for express privilege under the IRO for the purposes of collection of information for EOI purposes.

The Singapore Trustees Association has commented that the Singapore Bill should expressly extend privilege to cover legal advice from international lawyers and not just Singapore advocates and solicitors.

2.7 Notification of impacted persons

The HK Bill itself contains no provision for the notification of those persons in respect of whose information an EOI request is made. As noted above, the Brief indicates that under subsidiary legislation provision will be made for IRD to notify and provide a person who is the subject of a request with the information that the IRD is going to transmit to the requesting party so that person has the opportunity to verify the information and seek review by a higher authority (the Financial Secretary) if appropriate.

However, the FSTB has indicated to the Hong Kong General Chamber of Commerce Taxation Committee that the obligation to notify an impacted person of a request for their information will not extend to a foreigner outside of Hong Kong because IRD's jurisdiction is limited to Hong Kong.

Conclusion

It is notable that Singapore intends to enshrine the protection of confidentiality in primary legislation whereas Hong Kong proposes to implement wide enabling legislation with detailed matters and procedures being dealt with by the Administration by subsidiary legislation and IRD practice statements that may not be subject to the same public consultation. An individual's right to privacy and confidentiality is an important area of international law and ought to be protected by statute.

Whilst it would seem that there will be a process implemented by which an impacted person will be notified of an EOI request in relation to their information and will be able to verify and correct information to be provided under the EOI process, it is not clear that this will extend to judicial

supervision of the bona fides of the EOI request and the manner of implementation more generally. In this respect the proposed process incorporates less checks and balances than the proposed Singaporean legislation, which preserves greater protection for confidential information protected under the Banking Act or the Trust Companies Act. Hong Kong does not have legislation equivalent to that protecting confidential information under the Banking Act or the Trust Companies Act and the absence of such protection may have potentially harmful consequences for the financial community going forwards relative to Singapore. Hong Kong should, like Singapore, have a non-official body, i.e. a judicial or, at least a quasi-judicial body, to supervise EOI requests. It is important to ensure that proper checks and balances are in place and that these checks and balances are properly recorded before Hong Kong imports foreign tax systems so that people know what is going on. This is important for Hong Kong's territorial integrity. Hong Kong will also be at risk of losing customers to Singapore because of the lack of confidence and transparency in the non-judicial process that is proposed.

Confidential information in a trustee-beneficiary or banker-client relationship should be protected. Whilst Hong Kong does not currently have the same legislation as Singapore to protect this information, duties of confidentiality imposed by common law apply even without any statutory provisions. Information that is subject to such duties of confidentiality should be protected and it should make no difference whether this information is protected by statute or common law. It is important that investors, settlors and beneficiaries know that duties of confidentiality will continue to exist and be protected by judicial checks. It is also important that trustees, banks and other members of the financial community know that proper judicial procedures are in place to monitor exceptions to their own duties of confidentiality.

The judicial process urged for here will not protect the guilty seeking secrecy but will ensure innocent will have their legitimate desire for confidentiality protected.

It is important that consideration is given to the extension of legal professional privilege to cover international advice.

Consideration should also be given to the potentially harmful consequences of Hong Kong discriminating against foreign business by excluding any obligation to inform an impacted foreign person of an EOI request for their confidential information. This could seriously impact the perception of Hong Kong as an international financial centre for foreign investors.

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