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3 November 2009

CB(1)260/09-10(08)

By email: yhcheung@legco.gov.hk

Clerk to the Bills Committee
Legislative Council
Legislative Council Building
8 Jackson Road, Central
Hong Kong

Attn: Mr. Noel Sung

Dear Sir,

Bills Committee on Inland Revenue (Amendment) (No. 3) Bill 2009

1. INTRODUCTION

1.1. We refer to your letter of 21 October 2009 enclosing a copy of the FSTB's letter to the Clerk to the Bills Committee dated 21 October 2009 and its enclosures.

1.2. These documents set out where the various safeguards and procedures will be provided. Some will be in the relevant treaty itself, some will be in subsidiary rules and others in a proposed DIPN. The documents also contain a table summarizing the Administration's response to numerous points and concerns regarding the proposals that were contained in various written submissions to the Bills Committee, and others raised at the October 8th Bills Committee meeting. This submission addresses all these issues and also some of the oral responses made by the Administration to questions or concerns raised in the meeting by LegCo members or invited parties.

2. TIMING

2.1. We agree that this legislation (primary and subsidiary and DIPN) should be dealt with expeditiously for the reasons put forth by the Administration. However, we do not agree that Hong Kong is bound to adopt 12 OECD – blessed CDTA's by March 2010. Hong Kong is not on the grey list and is by no means dragging its feet on this issue. Other jurisdictions such as the US State of Delaware have much more work to do than Hong Kong – see the attached extract from STEP Worldwide's News Digest.

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2.2. Getting the right safeguards properly in place is more important than OECD pressure. The IRO amendments should not come into force until both the subsidiary legislation and DIPN are in place.

3. <u>JUDICIAL OVERSIGHT</u>

3.1. We re-iterate that the primary legislation should require a court order where information is sought from any requested party owing common law duties of confidentiality to the subject person.

3.2. The Administration's responses (Annex D – at Page 6) in answer to this Concern states:

"

- Singapore has a bank secrecy act and court order is required for obtaining such restricted information. The proposed amendments under its current EoI simply keep this court process for the restricted information only. The court process for information gathering does not apply to all other information for EoI purposes.

- As Hong Kong does not have bank secrecy law, introducing judicial sanction for collecting bank information will be seen as back-tracking on tax transparency."

3.3. Hong Kong's common law clearly imposes duties of confidentiality on bankers and fiduciaries such as trustees to their clients with respect to confidential information held by them. These duties are over-ridden by IRO's investigative powers for domestic tax interest just as Singapore's statutory bank and trust secrecy provisions are over-ridden by the Singapore Revenue's investigative powers for domestic tax interest.

3.4. Making such powers in relation to a foreign government's tax interest subject to a judicial oversight is important for several reasons:

3.4.1. Assisting foreign powers collect their taxes involves adopting in Hong Kong the foreign power's tax laws. This undermines Hong Kong's legal sovereignty and therefore should be subject to judicial oversight to ensure strict compliance with statutory safeguards and procedures. Judicial oversight of applications for assistance under the Mutual Legal Assistance in Criminal Matters Ordinance (Cap. 525) is for this precise purpose. There is no

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reason whatever why judicial oversight should not apply to assistance in tax matters.

3.4.2. In the absence of such judicial oversight the remedies available to either the subject person or the requested party are wholly inadequate. The Administration (at Page 11 Annex D – penultimate paragraph of their responses) states as follows:

"In any case, if a person thinks that the IRD has not properly discharged its responsibility to ensure that the information requested is within the scope of the relevant CDTA or the law, he can challenge the Government's actions through the judicial system."

3.4.3. This is not the case. The rights of a subject persons or a requested party to such a remedy (i.e. judicial review) are far from certain. Given the numerous circumstances under which the IRD can decline to give Notification of Proposed Disclosure (see paras 7 and 8 of Annex B – the so called "exceptional circumstances exception" to the duty to notify) there is every possibility that the subject person will not know about the proposed disclosure at all or at least until it is too late to request such judicial review.

3.4.4. If a subject person did receive notification in time and did seek a judicial review of the decision to request a third party to provide information (and presumably an interim injunction to stop the release of the information to the requesting state) this would, in fact, cause greater delay to the IRD in providing the information than a timely review by the courts.

3.5. We do not agree that timely judicial oversight in relation to access to information subject to the law of confidentiality would be seen as "back-tracking" on tax transparency. Singapore had OECD blessing for their judicial process so there is no apparent reason why the OECD would object to Hong Kong adopting a similar process. The Singapore judicial oversight is a check on process (and thus the observation of critical safeguards), legal professional privilege and public interest. It provides no barrier to access where the processes have been observed.

3.6. We re-iterate that keepers of confidential information such as banks and trustees deserve the protection of a court order before they breach their duties of confidentiality to their clients. The law should spell out their immunity in these circumstances.

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3.7. Law abiding clients will undoubtedly gain real comfort from knowing that their confidential information is afforded safeguards that are supervised by the courts. A well-advised client will undoubtedly favour Singapore over Hong Kong for this reason. It will result, quite unnecessarily, in Hong Kong losing quality and legitimate private banking and trustee business to Singapore. For example: Bank and trust companies may be instructed by their clients to transfer business to jurisdictions that offer the maximum legal and judicial safeguards to their clients' information being improperly or unnecessarily disclosed. Bank and trust companies themselves may also deem that it is prudent for them to book and administer business in those other jurisdictions, such as Singapore, with judicial oversight in order to avoid potential litigation by clients following disclosure in conflict with common law duties of confidentiality, especially when such disclosure was made without the subject person having been informed on a timely basis.

4. NOTIFICATION PROCEDURES

4.1. These are wholly inadequate and effectively make the giving of notice to the subject person at the Commissioner's option. The subject person's remedies (if available at all given the timing of notification) apart from judicial review, are limited to seeking to correct the information to be provided with a limited right of review within the Executive, i.e. the Financial Secretary. This involves no check whatever on the IRD's observation of the safeguards and is thus inadequate.

4.2. If there was judicial supervision of the process this would not be so important. Indeed if, like Singapore, the courts were given discretion as to whether to notify an impacted person of the application or the order it might not be necessary to have the IRD give notice at all with respect to requests for confidential information.

5. WHERE TO PUT THE SAFEGUARDS?

5.1. The Administration's principal argument for putting the safeguards and procedures anywhere but primary legislation is that they would need to amend the IRO every time they might need to "accommodate any slight change proposed by our negotiating partners" (Para 9 Annex A). This is simply not correct (see our suggestion 5.6 below). This also suggests that the Administration wants to be able to negotiate away safeguards, presumably in return for some treaty benefit such as a reduced withholding tax. We think this approach is wrong in principle.

5.2. Further, the Administration says that no other country puts safeguards in primary legislation. With respect, this is not correct – Singapore has. The Administration says

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that in any event, because the treaties themselves once negotiated become subsidiary legislation, they are thus subject to negative vetting by LegCo. Whilst this is true it is surely bad practice to let critical safeguards be subject to negotiation and to have the Government embarrassed by LegCo's rejection of a negotiated treaty.

5.3. The various safeguards can be seen as benefitting the jurisdiction itself, the holder of the information and the subject person ("the Stakeholders"). We submit that the most important safeguards are:

5.3.1. *Requests to be foreseeably relevant*
This is a safeguard against "fishing expeditions" by requiring specificity of the request. This protects all the Stakeholders.

5.3.2. *Confidentiality and limitations on usage of information exchanged*
This safeguard requires the information exchanged to be kept secret and only disclosed to tax assessors only for purposes of tax assessment, enforcement appeals etc. and not to be disclosed to any third jurisdiction. This primarily protects the subject person but also the jurisdiction.

5.3.3. *No retrospective effect*
The commencement date will be interpreted to mean that Hong Kong will decline any request from treaty partners to give retrospective effect. The Administration has clarified its position on this in Annex D (Page 8) in stating that "it will not involve information coming into existence before the CDTA's are signed". This primarily protects the holder of the information and the subject person.

5.3.4. *No automatic or spontaneous exchange*
The Administration has stated at Paragraph 8 of Annex A that "We will not accept any treaty benefit obligation for automatic or spontaneous exchange and will seek to agree with our negotiation partners on adopting only this mode of exchange." This protects all of the Stakeholders.

5.3.5. *Notification procedures*
These are set out in detail at paras. 5 – 11 of Annex B and primarily (although we submit inadequately) protect the subject person.

5.3.6. *Approval procedures*
These describe what the IRD must check in terms of the detailed information in request of the contracting party and how it fits with the relevant treaty

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before an information request can be made of a person in Hong Kong. The requirement that requests contain this detailed information is:

5.3.6.1. to guard against "fishing expeditions" by requiring specificity of the subject person, third party and the information sought.

5.3.6.2. to ensure that Hong Kong, in assisting the other country with the investigation, knows that it is the last resort (i.e. the other country has done all it can domestically to get the information), that we are not being asked to do what the other country couldn't do domestically, whether the enquiry is of a criminal nature or not and the stage of the investigation. Essentially, this information allows Hong Kong to satisfy itself beforehand that we are not damaging our legal system and values by adopting another country's inappropriate laws and standards; that is, it protects our sovereignty.

5.4. The Administration's proposal is that none of these should be in the primary legislation and only the Notification Rules should be in regulations subject to the positive vetting procedures. The protections contained in the treaties themselves are, when the treaty has already been negotiated, subject to negative vetting by LegCo. However, as stated above, LegCo would surely be generally disinclined to embarrass the Government by rejecting a negotiated treaty.

5.5. The most important safeguards to Hong Kong's sovereignty are relegated to a DIPN which is not subject to any legislative or judicial oversight and which in no way binds the IRD.

5.6. We urge adopting the approach taken in Singapore. That is, specifying in the primarily legislation the information which must be set out in the request by the requesting party. This way the most important jurisdictional protections get statutory status in a way that will not impact at all on the Administration's CDTA negotiating strength. Singapore has over 60 CDTA's and has recently renegotiated 11 treaties by adopting the latest OECD model article 26 within the confines of their amended revenue law including incorporating, in the primary legislation, specific requirements of requested information and judicial oversight.

5.7. As far as the CDTA negative vetting approach is concerned LegCo could rely on the Administration's published policies with respect to important protections (in the CDTA's themselves or policies surrounding them – see para 5.3 hereof) and satisfy

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itself that these have been adopted. We suggest that each CDTA submitted should be accompanied by a certification by the Administration with respect to these issues.

6. SUMMARY

6.1. Hong Kong is not on the OECD's Grey List. It therefore does not need to rush into 12 OECD 2004 Model CDTAs by March 2010. Our focus should be on getting this right.

6.2. The Bill should not come into effect before the proposed rules and DIPN are in place.

6.3. A court order for disclosure of confidential bank and trust information is necessary to protect our sovereignty and the subject person's rights and is feasible and sensible. It is acceptable to the OECD and critical to Hong Kong's competitive advantage vis-à-vis Singapore.

6.4. The IRO should specify the information to be provided by the requesting party to justify the IRD/Court making disclosure requests/orders. This promotes clarity and transparency, gives statutory protection to our sovereignty, and in no way restricts our negotiating power with other potential CDTA parties.

6.5. When the Administration submits CDTAs to LegCo for negative vetting they should certify their compliance in all respects with the Administration's declared policies on foreseeability, confidentiality, non-retrospectivity, adherence to domestic law and practice etc.

6.6. The IRD's obligations to inform subject persons of its intention to disclose information should be more certain and less conditional. Alternatively, if court approval is required for confidential information the Court should have discretion to inform the subject person and the requested party of the IRD's application and/or the disclosure order.

6.7. These changes to the proposals will give Hong Kong a clear, robust and internationally acceptable exchange of tax information regime. Sovereignty and taxpayers rights to confidentiality will receive protection and Hong Kong will not suffer competitive disadvantages to Singapore.

We enclose a separate Executive Summary comprising paragraph 6 of this letter.

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We are ready willing and able to meet with LegCo members and/or Administration Officers to explain or elaborate on any of these issues.

Yours sincerely

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EXECUTIVE SUMMARY OF SUBMISSION
TO INLAND REVENUE (AMENDMENT) (NO. 3) BILL 2009 COMMITTEE

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3. A court order for disclosure of confidential bank and trust information is necessary to protect our sovereignty and the subject person's rights and is feasible and sensible. It is acceptable to the OECD and critical to Hong Kong's competitive advantage vis-à-vis Singapore.

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5. When the Administration submits CDTAs to LegCo for negative vetting they should certify their compliance in all respects with the Administration's declared policies on foreseeability, confidentiality, non-retrospectivity, adherence to domestic law and practice etc.

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7. These changes to the proposals will give Hong Kong a clear, robust and internationally acceptable exchange of tax information regime. Sovereignty and taxpayers rights to confidentiality will receive protection and Hong Kong will not suffer competitive disadvantages to Singapore.

STEP HONG KONG
3 November 2009

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Delaware comes out top of the secrecy league
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The most secretive financial centre in the world by far is the US state of Delaware, according to a new international league table commissioned by the Tax Justice Network campaign group.

The US took in $2.6 trillion (GBP1.6 trillion) in deposits from non-resident corporations and individuals in 2007 - much of it through Delaware, says the TJN report.
The state is attractive because it imposes zero tax on foreign profits and does not demand that its 700,000 locally registered companies have a physical presence.
The report's authors ranked 60 jurisdictions by their "opacity score" and then weighted each by their importance in the global economy. After Delaware, the next three places in the Financial Secrecy Index fell to Luxembourg, Switzerland and the Cayman Islands,while London came fifth. This was mostly due to its size, but the report also criticised London's willingness to accept money transfers from the most secretive of international financial centres (IFCs), said report co-author Alex Cobham.
Also in the top ten were Bermuda, Singapore, Belgium and Ireland.
Tax Justice Network director John Christensen says the results prove that transparency in financial markets is a "chimaera", and far more complex than usually portrayed. He said trusts and certain types of companies were sometimes used to provide concealment beyond that achievable by bank secrecy.
The research was co-sponsored by Christian Aid, which takes interest in banking secrecy because of the large amounts of money that are illicitly channelled out of developing countries by corrupt officials and governments.

Sources

Financial Times

Reuters

The Independent

Christian Today

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Daniela Marucchi