



Law Society's Submissions

Financial Services and The Treasury Bureau Consultation Paper

Provision of Legal Framework for Entering into Tax Information Exchange Agreements (TIEAs)

The Law Society has reviewed the Financial Services and The Treasury Bureau's Consultation Paper: *Provision of Legal Framework for Entering into Tax Information Exchange Agreements (TIEAs)* (Consultation Paper) and has the following submissions:

INTRODUCTION

As a general proposition, while the Law Society has concluded that Hong Kong should proceed with the establishment of a comprehensive legal framework for TIEAs, it should be noted that:

- (a) the conclusion was reached with considerable reservation being expressed, and is noted in sections 2 paragraphs 2 and 3 in the answers to Question (a);
- (b) concern was expressed that the constitutional rights of privacy owed to Hong Kong citizens were not being protected by the Hong Kong Government ("HKG");
- (c) the approach of the HKG that the protections were enshrined in the Inland Revenue Rules ("the IRR") and Departmental and Interpretation Practice Note ("DIPN") is wholly unsatisfactory if not unacceptable and offered Hong Kong's taxpayers no statutory protection thus denying the citizen any right of appeal to the courts;
- (d) the HKG has accepted criticism of its tax system, but has not developed a coalition of other jurisdictions, or otherwise sought, to highlight the shortcomings of the tax systems of other jurisdictions; and
- (e) it appears that unelected bureaucrats residing half a world away have disproportionately more influence on Hong Kong's tax policy than Hong Kong residents themselves, which cannot be right.

QUESTION

- (a) *Should Hong Kong proceed to work on a legal framework for TIEAs?*

Law Society's response

Law Society's General Proposition

- 1.1 We agree Hong Kong should proceed to work on a comprehensive legal framework for TIEAs provided that adequate statutory protection be put in place to protect the constitutional rights of Hong Kong residents.

- 1.2 In 2009 the Law Society made the following submission on the Inland Revenue (Amendment) Bill 2010:

"It is fundamentally unsatisfactory that the legal provisions to allow for the implementation of EoI arrangements under CDTAs be dealt with through a piecemeal approach, i.e. in three separate documents (the Bill, the proposed IRR and the Departmental Interpretation and Practice Notes (DIPN)). Reference should be made to the Singapore legislation to incorporate all the relevant provisions in the Bill."

- 1.3 The Administration indicated the following in its response:

"It would not be necessary or desirable to stipulate in the primary legislation EoI safeguards that will be provided in individual CDTAs because each CDTA will be implemented as a piece of subsidiary legislation to be passed by Legco.

Stipulating these safeguards in the primary legislation would significantly constrain the Administration's flexibility in CDTA negotiations. Many jurisdictions may wish to adopt slightly different wording to meet their domestic needs. If the safeguards are set out in primary legislation, the Administration may need to amend the principal Ordinance every before it can accommodate any slight change proposed by the negotiation partners. This rigidity would severely reduce the attractiveness of Hong Kong as a treaty partner.

DIPN provides administrative guidelines of how an authorized officer of IRD will process an EoI request. As such administrative guidelines may be refined from time to time in line with international practice or operational needs, it is not appropriate to set them out as subsidiary legislation. The DIPN will be a public document drawn up after wide consultation. As with other DIPNs issued by IRD that set out guidelines on how it would implement Hong Kong's tax laws, IRD would consult stakeholders on any future amendment to the DIPN.

Agreed to make reference to section 105D(2) of, and the Eighth Schedule to Singapore's Income Tax (Amendment) (Exchange of Information) Bill 2009 and add similar provisions in the IRR which provide the same level of legal protection as the Bill.

Agreed to subject the Inland Revenue Rules (IRR) to positive vetting procedure, so that any future change would be subject to the scrutiny of Legco.

As stipulating the safeguards in the IRR or the Bill would provide the same level of protection, it is more consistent to set out the details for the carrying out of the CDTAs under the IRR."

In connection with the Administration's assertion that stipulating safeguards for individuals in the primary legislation would be impossible because of variations amongst CDTAs, our response is, with respect, that this cannot be so. The Exchange of Information articles in CDTA follow a prescribed model laid down by the Organisation for Economic Co-operation and Development ("the OECD") and are virtually the same in every CDTA.

2. Constitutional Rights of Hong Kong Residents

2.1 Article 39 of the Basic Law

The right to privacy is provided for in the Basic Law by virtue of Article 39 which provides:

"The provisions of the International Covenant on Civil and Political Rights ("ICCPR") ... as applied to Hong Kong shall remain in force and shall be implemented through the laws of the Hong Kong Special Administrative Region. The rights and freedoms enjoyed by Hong Kong residents shall not be restricted unless as prescribed by law. Such restrictions shall not contravene the provisions of the preceding paragraph of this Article."

2.1.2 Article 17 of the ICCPR

- "1. No one shall be subjected to arbitrary or unlawful interference with his privacy, family, home or correspondence, nor to unlawful attacks on his honour and reputation.*
- 2. Everyone has the right to the protection of the law against such interference or attacks. [emphasis added]"*

2.1.3 Article 35 of the Basic Law

This stipulates the following rights of residents:

"Hong Kong residents shall have the right to confidential legal advice, access to the courts, choice of lawyers for timely protection of their lawful rights and interests or for representation in the courts, and to judicial remedies.

Hong Kong residents shall have the right to institute legal proceedings in the courts against the acts of the executive authorities and their personnel."

2.2 Inland Revenue (Disclosure of Information) Rules, Cap. 112BI (Rules)

2.2.1 In the present case, under rule 5(1) we note an individual is only told:

- (a) the nature of the information requested; and
- (b) that the person may request a copy of the information that the Commissioner is prepared to disclose to the requesting government.

2.2.2 Any objection by the individual under rule 5(3)(b) is limited to asking that the information be amended only on the following grounds:

- (i) the information not being related to the person; or
- (ii) the information being factually incorrect.

2.3 Rules 6 and 7 of the Rules

2.3.1 We note there is no right of recourse to the courts under the Rules.

2.3.2 Under rules 6 and 7, any request for information to be amended can only be made to the Commissioner of Inland Revenue (CIR) or the Financial Secretary (FS), with the decision of the latter being final.

2.3.3 Under the terms of the Model TIEA provided by the FSTB, there are several safeguards provided to protect taxpayers.

2.4 Model TIEA

2.4.1 Article 1

2.4.2 This provides for information to be exchanged pursuant to the Model TIEA limited to information that is “*foreseeably relevant*” to the determination, assessment and collection of taxes, the recovery and enforcement of tax claims or the investigation or prosecution of tax matters.

2.4.3 “Foreseeably relevant”

This has been interpreted by the High Court of Singapore to mean that there must be “*some clear and specific evidence that there is a connection between the information requested and the enforcement of the requesting state’s tax laws.*” (Comptroller of Income Tax v AZP [2012] SGHC 112) (AZP).

2.4.4 In Hong Kong we note it would be virtually impossible for a person to mount a challenge on this basis as they would only be entitled under rule 5(1) to know the nature of the information requested and obtain a copy of the information that the CIR is prepared to disclose. The relevance of the information would not be disclosed to the taxpayer. Moreover, rule 5(3)(b) would not permit them to challenge on that basis.

2.5 Article 7(2)

2.5.1 Under Article 7(2) there is also no obligation to supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process. Again, there is no basis in the Rules to make a challenge.

2.5.2 Article 7(3) provides that information subject to legal professional privilege does not need to be disclosed. Again, there is no recognition of this in the Hong Kong legislation, unlike Singapore, where this is entrenched in s.105K(4)(a) of the Income Tax Act, and in Hong Kong a challenge on this basis is also not permitted under rule 5(3)(b).

3 Is there adequate protection of the constitutional rights of Hong Kong residents?

3.1 It is clear that under the Basic Law and the common law there are certain fundamental rights which must be protected, namely: the right to privacy, the right to legal professional privilege, and further accepting there are certain rights protected by the treaties themselves, we ask whether, the rights of Hong Kong residents are adequately protected under Hong Kong's current legislation and practice -

In our opinion, the answer must be no.

3.2 First, any infringement of the constitutional right to privacy must be "prescribed by law". The Court of Final Appeal in *Leung Kwok Hung & Others v HKSAR* [2005] HKCU 887 (at paras. 25-29) held that the term entailed the principle of legal certainty.

3.2.1 The legislation restricting the right must be formulated with sufficient precision to enable the citizen to regulate his conduct. A law that confers discretionary powers on public officials, the exercise of which may interfere with fundamental rights, must give an adequate indication of the scope and manner of exercise of the discretion conferred.

3.2.2 Given the current approach, the individual will not know, in the majority of cases, whether his rights are being violated as his legal right to be notified or to object is extremely limited. The alleged protections provided by the government by way of the procedures or policies set out in the DIPN No.47 are an embarrassment and can offer little comfort to citizens and residents of Hong Kong. On the covering page it states:

"These notes are issued for the information of taxpayers and their tax representatives. They contain the Department's interpretation and practices in relation to the law as it stood at the date of publication. Taxpayers are reminded that their right of objection against the assessment and their right of appeal to the Commissioner, the Board of Review or the Court are not affected by the application of these notes."

3.2.3 In other words, the DIPN reflect only the Inland Revenue Department's views as of June 2010 - nothing more or less. They do not have the force of law.

3.2.4 Case law also establishes that these are not binding¹, meaning that the protection of fundamental human rights such as the right to the protection of legal professional privilege and the right to privacy are sustained by nothing more than an interpretation applicable only on the date it is issued. It provides no certainty to the individual, no precision, and a completely inadequate indication of how discretion will be exercised on a day to day basis (although we have some limited certainty for June 2010).

3.2.5 The second major flaw is that Article 35 of the Basic Law, outlined above, gives Hong Kong residents a right to access the courts, whereas the government in this legislation has specifically attempted to preclude this access.

¹ See for example D54/06, in which the Board of Review said at para 25 that "The Practice Note issued by the Commissioner was issued for the guidance of taxpayers and their authorized representative. It may represent the view of the Commissioner. But as is made clear in the Notes, it has no binding force of law. It does not bind the Board. The Board must approach each case by applying the law to the facts. It would not be right or necessary for the Board to consider whether the facts of a given case fall within certain paragraphs on the Notes; and certainly wrong for the Board to determine a case as if the Notes represents the law.", or D59/03, in which it was said at para 31 that ".....Furthermore, as expressed in all Departmental Interpretation and Practice Notes, its [the IRD's] notes are issued for the information and guidance of taxpayers. They have no binding force and do not affect a person's right of objection or appeal to the Commissioner, the Board of Review or the Courts." (emphasis added)

- 3.2.6 In *Lee Yee Shing Jacky v Board Of Review (Inland Revenue Ordinance)* [2012] HKCU 738, it was held that the right of access to court entailed a right of access to a decision-maker that is independent and impartial or one that is controlled by a judicial body with full jurisdiction right. Any restriction upon this right must pursue a legitimate aim and there must be a reasonable relationship of proportionality between the means employed and the aim sought to be achieved. It was found in that case that there were avenues by way of appeal to the CFI or judicial review for a taxpayer to challenge a tax assessment. Similar provision of appeal to a court is lacking in the Inland Revenue Rules and this must suggest that the current Rules are unconstitutional in nature.
- 3.2.7 Finally, any restriction of a constitutional right must satisfy the proportionality test as laid down by *Leung Kwok Hung* (above) and applied by *HKSAR v Muhammad Riaz Khan* [2012] HKCU 1063 (also a right to privacy case). The test is that:
- (a) the restriction must be rationally connected with one or more of the legitimate purposes; and
 - (b) the means used to impair the right must be no more than is necessary to accomplish the legitimate purpose in question.
- 3.2.8 This means that the onus should be on the government to explain what the rational reason is for not allowing individuals to object to disclosure on the basis that the information is legally privileged, for example, or to explain why they have specifically attempted to preclude access to the courts. They also need to explain why the protections offered are in *non-binding* Practice Notes lacking any legal or legislative backing instead of legislation where the individuals concerned would have access to the courts.
- 3.2.9 The legislative framework for TIEAs must contain:
- (a) Restriction on the disclosure of items subject to legal professional privilege;
 - (b) Individuals should be able to challenge information disclosures not merely on the basis that the information is factually incorrect, but also on the basis that it is legally privileged, would disclose a trade, business, industrial, commercial or professional secret or trade process, or on the basis that it is not foreseeably relevant;
 - (c) There must be a right to appeal to the courts in order to satisfy the test of Article 35 of the Basic Law or the government should explain what overriding objective requires that residents be denied a constitutional right. In short, the individual should have by law all of the protections mandated constitutionally or by the terms of the treaty. We trust the Administration will not attempt to defend the existing unsatisfactory situation by re-iterating its views that statutory safeguards “*in the primary legislation would significantly constrain the Administration’s flexibility in [TIEA] negotiations.*”
- 3.2.10 In our submission any protection that the government can put into a DIPN or a TIEA can also be put into legislation. If not the government must provide a full explanation.

4. Matters in the DIPN which should be placed in the legal framework

We have reviewed the DIPN and note the following matters should be placed within the legislative framework as follows:

4.1 Exchange of Information upon request only

4.1.1 Paragraphs 15-17 of the DIPN provides commentary on “*Exchange of Information upon request only*” and that “Hong Kong’s policy on the exchange of information is restricted to exchange upon request only and we will not agree to engage in automatic or spontaneous exchanges.....”

4.1.2 We submit this principle should be clearly stated in the legislation.

4.2. Restricted to taxes covered by the CDTAs

4.2.1 Paragraph 20 of the DIPN notes “...*jurisdictions are free to restrict the scope of information exchange to the taxes covered by the CDTAs*”

4.2.2 We submit this principle should be clearly stated in the legislation.

4.3 Use of information for tax purposes only

4.3.1 Paragraph 27 of the DIPN states:

“the information pursuant to the CDTAs cannot be used for non-tax purposes. For instance, tax information obtained pursuant to a CDTA must not be used for the prosecution of non-related crimes or offences”.

4.3.2 We note the schedule to the Rules does not state this exclusively and we submit this principle should be clearly stated in the legislation.

4.4 Sharing of tax information

4.4.1 Paragraph 30 of the DIPN states:

“Some jurisdictions may request that the CDTA provides for sharing of tax information by authorities with other law enforcement authorities and judicial authorities on matters such as money laundering, corruption or terrorism financing. The OECD Model EoI Article does not create an obligation upon Hong Kong to do so and it is not Hong Kong’s policy to accede to such request to permit the sharing of information for any non-tax related purposes as specified in the EoI Article under the sample CDTA text at Annex B. We would bring this point to the attention of our potential contracting party in treaty negotiations.”

4.4.2 This policy is beyond dispute and should be incorporated in the legislation.

4.5 No disclosure to oversight authority.

4.5.1 We note Hong Kong has a policy that unless there are legitimate reasons given by the requesting party (e.g. administrative or governmental structure of the treaty partner permits or requires the oversight authorities to have access to tax information), we do not permit disclosure to oversight authorities, and will reflect this intent in the text of the CDTA accordingly.

4.5.2 Even in a case in which disclosure is permitted such disclosure would be in accordance with the provisions in the respective CDTA only. We note oversight authorities are “authorities that supervise the tax administration and enforcement authorities as part of the general administration of the government of the contracting parties.” As an illustration, in the case of Hong Kong, the information exchanged “*would not be disclosed to the Financial Services and the Treasury Bureau of the Hong Kong Government*”.

4.5.3 We submit the legislative framework for TIEAs should specifically state that Hong Kong would not permit disclosure of information to oversight authorities.

4.6 No disclosure to third jurisdiction.

4.6.1 The DIPN notes in paragraph 32 that

“to ensure the strictest confidentiality, we will seek to provide in the CDTA that information shall not be disclosed to any third jurisdiction for any purpose”.

4.6.2 We submit such provisions should be in the legal framework.

4.7 No obligation to carry out measures at variance with domestic laws and practices

4.7.1 The DIPN states in paragraph 35:

“... a contracting party should be required to do no more, but also no less, than it would if its own taxation were at stake.”

4.7.2 We submit this provision should be in the legal framework.

4.8 No obligation to provide information not obtainable under domestic law

4.8.1 The DIPN states in paragraph 36:

“... either party is free to decline to provide information if the information cannot be obtained under its domestic law or cannot be obtained in the normal course of administration.”

4.8.2 We submit such provisions should be in the legal framework.

4.9 Legal Professional Privilege (LPP)

- 4.9.1 We note section 51(4A) of the IRO provides protections for LPP. The Law Society submits the TIEA legal framework must specifically cite this protection.

QUESTION

- (b) *What are the considerations that we should take into account in choosing CDTA and TIEA partners?*

Law Society's response

- 5.1 The Consultation Paper indicates the Administration will proceed to negotiate CDTA as a starting position. However, we note the Global Forum has indicated that *“a preference for CDTA over TIEA cannot be a reason for refusing to enter into an EoI agreement, otherwise the jurisdiction concerned (Hong Kong) would be considered not in compliance with the principle that a jurisdiction should not refuse to enter into EoI agreements with relevant partners”*. We have the following observations on the matters to be taken into account when choosing a CDTA or a TIEA:

5.2 Comprehensive Avoidance of Double Taxation Agreements (CDTAs)

- 5.2.1 We note the purpose of CDTAs is to attract cross border investment, promote trade and avoid or reduce the incidence of double taxation. If a Hong Kong resident knows that he is going to be taxed in his home and foreign jurisdictions at full rates in each jurisdiction or suffer high withholding taxes, then he is unlikely to make an investment outside his home jurisdiction. If he does make an investment outside his home jurisdiction, he is very likely to direct his investment to places where he will not suffer high rates of withholding tax.
- 5.2.2 When a Hong Kong resident makes an investment in an overseas jurisdiction, particularly one involving industry, he brings:
- finance;
 - perhaps the need for additional finance to be sourced in the overseas jurisdiction where the investment is made upon which interest may be paid and brought into charge for tax purposes in that jurisdiction;
 - employment where income taxes are paid by employees;
 - hopefully profits on which he will pay tax in the overseas jurisdiction;
 - new technology, particularly in industry.

Any Hong Kong resident bringing to a venture the following:

- finance - will usually want to receive interest;
- technology or other intellectual property - will want to receive a royalty
- profits - will want to share in those profits, usually by way of a dividend

We note interest, royalties and dividends are taxed at substantial rates on the gross payments from the country where the interest, royalty or dividend is paid. CDTAs contain reduced rates of withholding taxes which is the *quid pro quo* for investing in the overseas jurisdiction.

5.2.3 By making an investment in a country, a Hong Kong resident is bringing an economic benefit to that country and paying tax in that country. Such investments are not without risk and thus there should be a reward due to the investor. CDTAs achieve this by reduced withholding taxes.

5.2.4 Aside from the potential reduction in tax rates, a CDTA also serves important tax purposes in cross border businesses and commerce by allocating taxing rights, defining the concept of permanent establishment, and defining tax residency

5.3 TIEAs

5.3.1 TIEAs bring only the ability to exchange information and will not bring any economic benefit save to the jurisdiction which is seeking the information for its own tax purposes.

5.3.2 We note there will be pressure on Hong Kong to negotiate TIEAs not CDTAs. The Law Society states a preference for the Government to negotiate CDTAs in the light of our comments above. We consider the Government should enter into CDTAs where:

- the other contracting party is a significant trading or investment partner;
- the investing country is providing significant financial investment, support or other resources in or to the other contracting party;
- significant internal tax benefits will accrue to the other contracting party (as described above);

In relation to requests for TIEAs we have the following observations on issues of principle:

- As TIEAs are reciprocal treaties, Hong Kong should not contract with a state which does not have in place the full and complete legal and regulatory framework which permits the contracting state to obtain, retrieve and supply the required information to Hong Kong;
- Hong Kong should not contract with a country which has a poor human rights record;

- Hong Kong, subject to other considerations, could enter into TIEAs where there is no risk of double taxation;
 - the other contracting party levies no internal income taxes or has a sourced based system of tax;
 - the Administration should ensure the relevant jurisdiction has a corresponding respect for the rule of law and property rights;
 - should only enter into TIEA where the other contracting party is unable or unwilling to enter into CDTAs; and
 - should not enter into TIEA simply because it is more expeditious to negotiate than a CDTA.
- 5.3.3 If Hong Kong declines to enter into a TIEA there is significant risk that we would be regarded as an un-cooperative jurisdiction and face being black-listed or even sanctions.
- 5.3.4 Thus the CIR should negotiate CDTAs with significant trading or investment partners, and with territories that have residence - based income tax regimes, and with territories that levy substantial withholding taxes.
- 5.3.5 The CIR could seek to negotiate TIEAs with territories with which Hong Kong has insignificant trade or investment, and with territories that do not levy any income tax (tax havens), or that have source-based income tax regimes, and with territories that do not charge any withholding taxes.

QUESTION

- (c) *Do you have any other suggestions on the implementation of the CDTA and TIEA programmes?*

Law Society's response

- 6.1 The HKG should ensure the requesting party will be responsible for the cost of providing assistance as provided for in Article 9 of the Model Agreement on TIEA.
- 6.1.2 CDTAs are limited in scope. Jurisdictions seeking TIEAs may negotiate more comprehensive agreements and this will require additional government resources. The cost of investigation should not be borne by the Hong Kong taxpayer. In all probability, IRD will have to investigate as the IRD is unlikely to have on file the requested information.
- 6.1.1 The CIR must have adequate resources to handle requests under TIEAs.

QUESTION

(d) *What are the specific concerns for not supporting the legal framework for TIEA?*

Law Society's response

7.1 The Law Society's concerns have been expressed in its response to questions (a) to (c) above.

QUESTION

(e) *Are there any possible ways to address these concerns?*

Law Society's response

8.1 We are of the view that in light of the statutory rights of Singaporean citizens to challenge requests for information before its courts, any failure by the HKG to entrench similar rights of Hong Kong taxpayers in its domestic legislation would adversely affect Hong Kong's standing as the pre-eminent financial centre in Asia - a cornerstone of the HKG policy.

8.2 The Government must negotiate any TIEAs according to CDTA standards. The "safeguards" outlined in paragraph 22 of the Consultation Paper are inadequate and need to be strengthened per our comments above.

The Law Society of Hong Kong
Revenue Law Committee
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