

**Consultation on the Provision of Legal Framework for entering into Tax
Information Exchange Agreements ('TIEAs')**

**Society of Trust and Estate Practitioners Hong Kong Branch ('STEP HK')
Hong Kong Trustees' Association ('HKTA')
Joint Response to the FSTB Consultation Paper issued on 4 May 2012**

QUESTIONS

- Q1 Should Hong Kong proceed to work on a legal framework for TIEAs?
- Q2 What are the considerations that we should take into account in choosing CDTA and TIEA partners?
- Q3 Do you have any other suggestions on the implementation of the CDTA and TIEA programmes?
- Q4 What are the specific concerns for not supporting the legal framework for TIEA?
- Q5 Are there any possible ways to address these concerns?
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ANSWERS

Q1: *Should Hong Kong proceed to work on a legal framework for TIEAs?*

The Society of Trust and Estate Practitioners ('STEP') is the leading worldwide professional body for those advising families on cross-border wealth structuring. STEP unequivocally condemns tax evasion and supports international efforts to improve tax transparency if accompanied by appropriate safeguards to protect legitimate client confidentiality. STEP believes that TIEAs are a sensible OECD-level response to the problem of tax evasion and that TIEAs are a powerful disincentive to anyone to evade taxes by hiding their money in another country. We urge you to carefully consider the STEP Policy Briefing attached as Appendix 1¹ as it considers the various issues in depth.

STEP HK is a branch of STEP and its membership includes professionals from the legal, accounting and financial services fields in Hong Kong. STEP HK is committed to the promotion and enhancement of the Hong Kong trust industry.

¹ STEP Policy Briefing 'Making Tax Data Exchange Secure' – August 2010

Hong Kong Trustees' Association is an independent body representing the trust industry in Hong Kong. HKTA actively promotes best practices in the trust industry and supports its members to comply with local laws as well as international standards.

We recognise that Hong Kong is the only member of The OECD Global Forum on Transparency and Exchange of Information for Tax Purposes (the '**Global Forum**') yet to amend its legal framework to allow entry into TIEAs. Having regard to this, and to international economic developments since the government's last consultation on EOI, we believe that it is no longer credible for Hong Kong, as a responsible member of the international community and global economic centre, and a member of Global Forum to resist the introduction of a legal framework for TIEAs. However we believe that **both** the granting of a TIEA and the exchange of information ('**EOI**') pursuant to a TIEA must be subject to appropriate safeguards, which are considered further below, to protect legitimate client confidentiality.

It must be remembered that a fundamental reason that the Inland Revenue Department ('**IRD**') was granted rights to compel Hong Kong taxpayers to give up detailed personal information to them was the promise that that information be kept secret by the government. That promise (section 4 Inland Revenue Ordinance) clearly imposes on the government the duty to do its utmost to protect information provided to other jurisdictions under EOI provision as an exception to section 4.

Q2: What are the considerations that we should take into account in choosing CDTA/TIEA partners?

Choice of CDTA/TIEA partners

We recognise that CDTA and TIEA negotiations can be extremely time consuming and believe the Hong Kong government should focus on negotiating CDTAs with its existing major international trading partners and those countries with whom Hong Kong wishes to develop closer economic relations, secure EOI, or avoid reputational damage, for the benefit of the Hong Kong people, its investors and business community.

We consider that a CDTA will be preferable to a TIEA and note the assurances given by the FSTB in its consultations with stakeholders to the effect that the government places great priority on the securing of CDTAs. We urge a robust "CDTA first" approach. We believe that Hong Kong, being an important centre of export and import capital (particularly for China) has a lot more to offer other states than simply EOI. We also think Hong Kong should not underestimate the potential administrative and other costs of entering into TIEAs.

Of the two tools, we believe that CDTA potentially brings economic benefits to Hong Kong people and Hong Kong based investors and businesses, while it is difficult to appreciate what economic benefits accrue to Hong Kong from entering into a TIEA. Whilst we support amendment to the legislative framework to facilitate TIEAs, we urge the Hong Kong government to carefully consider, and to make public its policy position, regarding when Hong Kong may entertain negotiation of each agreement.

It is a pity that Hong Kong did not conclude more CDTA's with our major trading partners prior to signing up to the Global Forum as this appears to have compromised its bargaining power for future CDTA's, particularly with certain jurisdictions.

There should be no automatic entitlement to a TIEA if a CDTA cannot be negotiated

We accept that, as a member of the Global Forum, the Hong Kong government is committed to the principle of tax transparency and effective EOI for tax purposes.

We also recognise that it is desirable that Hong Kong be viewed by the international community as meeting the Global Forum standard of EOI, as determined in accordance with the Terms of Reference of the Phase 2 Peer Review. However, we think it would be a mistake for Hong Kong to conclude, or accept, that the only way to meet this standard is to grant a TIEA to all prospective partners requesting EOI with whom a CDTA cannot be negotiated. We believe that the Hong Kong government should have a clear policy to determine whether a potential partner is an acceptable partner for the purpose of EOI and should be prepared to reject a potential partner (or withdraw TIEA benefits from an existing partner) in appropriate cases. For example, if the partner cannot demonstrate proper adherence to minimum standards to protect the privacy of confidential data supplied pursuant to the EOI process.

The Terms of Reference developed by the Peer Review Group and agreed by the Global Forum break standards down into 10 essential elements against which jurisdictions are reviewed. One of these 10 essential elements relates to the identification of EOI partners:

C.2. The jurisdictions' network of information exchange mechanisms should cover all relevant partners.

This is a long-standing principle agreed by the Global Forum's Sub-group on Level Playing Field Issues as long ago as 2008². However, tax transparency has been an evolving standard. At its London Summit, on 2 April 2009, the G20 agreed a threshold of 12 tax treaties (containing appropriate EOI clauses) for a country to be included on the OECD white list of 'compliant' countries. In 2010 the Global Forum stated in its Terms of Reference that 12 tax treaties were

² Taking the Process Forward in a Practical Way (November 2008)

likely too few to allow for exchange with all 'relevant' requesting jurisdictions. Whether a jurisdiction met the international standard of tax transparency would be determined by way of an in-depth peer review conducted in 2 phases. The Terms of Reference now provide that a 'relevant' partner means those partners that are interested in entering into an information exchange agreement.³

However, granting EOI arrangements is only one of the essential elements of the Terms of Reference, which have to be assessed. In this regard, two further essential elements of the Terms of Reference require consideration:

C.3. The jurisdictions' mechanisms of exchange of information should have adequate provisions to ensure the confidentiality of information received.

C.4 The exchange of information mechanisms should respect the rights and safeguards of taxpayers and third parties.

It follows that the proper protection of confidential tax information **received** by partners should be an important consideration for the Hong Kong government when deciding **both** whether to grant a CDTA or TIEA and when to permit EOI pursuant to a CDTA or TIEA.

In this respect we note that the Phase 1 Peer Reviews that have taken place do take into consideration the confidentiality protections implemented by the country under review for information **received** by them under EOI. However the concern remains that, despite legal frameworks in place, certain countries are less reliable than others in assuring their taxpayers that their confidential financial data will not be used for criminal purposes owing to corruption. We suggest the Hong Kong government should be mindful of this, and the need for an ongoing monitoring of such protections, when negotiating with potential partners. We recommend that the government establish and publish minimum criteria for data protection in countries with which we would engage in EOI either through CDTA or TIEA.

These issues are addressed in more detail in the STEP Policy Paper 'Making Tax Data Exchange Secure' appearing as Appendix 1 to this Joint Response.

Distinguishing tax privacy from tax transparency

Whilst acknowledging the importance of tax transparency in tackling tax evasion, we believe that EOI arrangements must be balanced by appropriate safeguards to protect legitimate rights to privacy of personal financial information. The importance of the protection of personal data is

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Global Forum's 2010 Terms of Reference to Monitor and Review Progress Towards Transparency and Exchange of Information for Tax Purposes - Footnote 26

recognised by the government in the Personal Data (Privacy) Ordinance, which recognises in particular the need for care in the area of international data transfers.

Data protection legislation is common in developed countries. However, there are many salutary examples of government failings in data protection, even by governments with political stability and that have a legislative framework for data protection.

In November 2007, the UK tax authorities lost computer discs containing personal information of every family in Britain with a child under 16 (approximately 25 million people).⁴ In April 2008, the Italian revenue authorities briefly posted the tax returns of all Italian taxpayers for 2005 on their official website.⁵ Despite a reversal by the tax authorities, it was reported that the tax returns remained available on file-sharing sites. According to an article in the Economist magazine, CD's of the Italian database were made available, same day on E-bay for \$75, showing how effectively private parties exploit government lapses. Media reports in the Italian press at the time noted that the result of the data publication by the Italian authorities was that the mafia's efforts at kidnapping and extortion would be aided by use of the government database which would spare them the effort of research on potential victims.⁶

There is strong political pressure to bring many of the world's poorest countries into the EOI framework. Yet without adequate safeguards for data received by such partners there is the systemic risk of sensitive data passing into the hands of despotic or corrupt government officials or organised criminals. A vicious circle emerges whereby developing countries lose the vital tax revenues necessary for investment in improved national governance and improvement of the welfare of their residents because poor governance puts the financial and personal security of the wealthier taxpayers and businesses on whom they depend for revenue at risk.

International standards must not be prescriptively cast in stone and the members of the Global Forum have a responsibility to adapt as necessary to evolving circumstances. Now that the Global Forum has achieved exponential success in facilitating cooperation between nations for the purpose of tax transparency, we believe that the Global Forum must continue to evolve and adapt to recognise the next generation of challenges. These challenges include the explosion and management of electronic data (which can be easily replicated and maintained indefinitely); the growing recognition of the need for protection of private data (especially electronic data

⁴ See <http://www.independent.co.uk/news/uk/politics/lost-in-the-post-the-personal-details-of-25-million-people-758867.html>

⁵ See <http://www.guardian.co.uk/world/2008/may/02/italy>

⁶ STEP Response to the OECD Public Discussion Paper on High Net Worth Individuals issued 30 October 2008 - para 4.5

moving across borders) and the continuing battle against corruption and organised crime as they apply to financial and personal security of taxpayers including, in particular, government corruption, hacking, identity theft and kidnapping.

For a detailed examination on the related issues of privacy and EOI we attach as Appendix 2 a research paper prepared by William Ahern for his LLM in International and European Law.

Finally, in answer to this question, we urge the government to be rigorous in insisting on the “level playing field” principle by refusing to collect data where potential EOI parties have been shown to have failed to collect data themselves.

Q3: Do you have any other suggestions on the implementation of the CDTA and TIEA programmes?

Additional legislative safeguards should be introduced for EOI under a CDTA/TIEA

We understand that there have been only 31 requests for EOI since 2010 of which 4 were refused. Given that many of our new treaties have only come into force relatively recently, we do not believe that this small sample can be taken as a meaningful guide of the likely EOI requests that Hong Kong will receive in future, or as evidence that the safeguards introduced by the Inland Revenue (Disclosure of Information) Rules are sufficient to reassure Hong Kong residents, investors and businesses that their legitimate client confidentiality will be protected in Hong Kong to the same level as other jurisdictions with judicial protection for a person being the subject of a EOI request, such as Singapore. Investors and businesses having a choice as to the jurisdictions with whom they conduct business frequently take advice as to the comparative legal and commercial merits of different jurisdictions. We believe that the judicial oversight of EOI requests will give Singapore a commercial advantage over Hong Kong.

We are particularly concerned that much of the ‘safeguards’ currently exist only in an Inland Revenue Department Departmental Interpretation and Practice Notes (DIPN 47), which has no force of law whatsoever. The problem is twofold. First, there is no transparency as to whether the safeguards are consistently administered. Second, in the event that the safeguards may not be consistently administered, there is no mechanism for the taxpayer to find out or to challenge the IRD’s decision to exchange the information. (The Disclosure of Information Rules only allows a taxpayer to object on the basis that the information is factually incorrect. A taxpayer cannot object on the basis that the EOI breaches the safeguard stated in a DIPN.) Indeed, a court of law cannot take into account the views of the IRD as stated in a DIPN if it was to determine the legal position of a taxpayer. The safeguards should all be contained in relevant legislations.

Finally, we consider that the government should give serious consideration to the constitutional implications of its EOI framework having regard to the right to privacy provided by Article 39 of the Basic Law (applying Article 17 of the International Covenant on Civil and Political Rights) and the right to judicial remedies provided by Article 35 of the Basic Law. Legitimate privacy of financial information is an important aspect of the right to privacy and it is important that the government does not release information to other governments without similar commitment to the right to privacy. We believe that the government should also address whether allowing responses to EOI requests to be determined by the Inland Revenue Department or Financial Secretary without a judicial oversight process is a breach of Article 35.

Q4: *What are the specific concerns for not supporting the legal framework for TIEAs?*

STEP HK supports the provision of a legal framework for TIEAs in principle. However the manner in which that framework is implemented in practice will be of critical importance to ensure there are appropriate safeguards to protect legitimate client confidentiality.

Q5: *Are there any possible ways to address these concerns?*

Proactive representation of the legitimate interests of Hong Kong people and clients of the Hong Kong financial community within the Global Forum

As an important international financial centre, and as a jurisdiction which has long taken a stance on corruption and organised crime, we believe that Hong Kong should take a lead in helping the Global Forum to meet the challenge of preserving legitimate tax privacy amid increasing international transparency and transmission of private data across borders.

Development of a Realistic and 'Open' Policy

When the government consulted with stakeholders concerning amendment of the IRO to facilitate CDTAs, many stakeholders were reassured by promises that the government would resist

amendment of local legislation to facilitate entry into TIEAs. This assurance is reflected also in DIPN 47 (Exchange of Information Under Comprehensive Double Taxation Agreements).⁷

It is important for Hong Kong businesses and investors to be confident that the government will have a predictable approach to entry into CDTAs and TIEAs and to EOI more generally. We recommend that the government publish its medium to long term policy on EOI having regard to the fact that international standards are continually shifting and moving towards automatic EOI. In particular, industry will welcome views from the Hong Kong government on the pending imposition of its Foreign Accounts Tax Compliance Act ('**FATCA**') on foreign financial institutions and investors by the USA. We recommend that the government inform the public at an early stage before entering into negotiation of a CDTA or TIEA with any country, and further that the government consult with Legco before signing any TIEA or CDTA (rather than relying on negative vetting after the fact).

Co-ordination of governmental policy

The Hong Kong government appears to have split up the topics of TIEAs, the USA's FATCA initiative and Anti-Money Laundering initiatives between separate governmental teams. These three topics raise common issues for the financial community and Hong Kong people with international interests. We would urge the Hong Kong government to adopt a unified approach to these various topics to avoid inconsistent policies and uncoordinated implementation which will potentially increase compliance costs for Hong Kong businesses and individuals.

We urge the government to quickly establish a standing advisory committee with representatives from the legal and accounting professions with expertise in cross-border tax and wealth planning to advise it on the various areas mentioned above. This will assist the government in adopting an holistic approach to these complex and critical issues. Such an approach is fundamental to the fulfilment of Hong Kong's ambition to be the region's leading financial centre for private wealth management.

Periodic review of CDTA/TIEAs in force and the effective operation of safeguards in place

We recommend that there should be independent oversight and supervision mechanisms for TIEAs and safeguards in place. For example we recommend:

- (a) regular review of the continuing suitability of our treaty partners including their meeting of the criteria for the protection of received data;

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See para 5.

- (b) annual publication of the number (and source) of requests for EOI pursuant to both CDTAs and TIEAs; and
- (c) annual publication of EOI information requests rejected, and review of the objections to disclosure raised by the subjects of EOI requests, to ensure proper oversight of implementation of the safeguards.

We recommend that the Inland Revenue Board of Review be charged with these functions. Whilst this is not as robust as judicial supervision, it does represent an independent body overseeing these critical safeguards and will provide our taxpayers, investors and businesses a degree of confidence in the adequacy of these safeguards.

Submission on 5 July 2012

By:

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