

**<sup>1</sup>STEP HK**  
**SUBMISSION TO THE**  
**LEGISLATIVE COUNCIL BILLS COMMITTEE**  
**ON THE INLAND REVENUE (AMENDMENT) BILL 2016**

**A. Background**

1. STEP (see [www.step.org](http://www.step.org)) is the peak global representative body of 20,000 individuals who advise families on passing wealth across the generations. We regard the issue of the confidentiality of personal financial information of the families our members represent as firmly within our remit. We have no corporate members although many of our members work for corporates. We do not represent banks or other institutions. We regularly make submissions regarding government initiatives around the world and made representations and submissions to the OECD in the formulation of CRS. STEP unequivocally opposes tax evasion (the deliberate non-disclosure of reportable tax information or the deliberate presentation of false or misleading reportable tax information) everywhere. STEP also fully recognises that the globalization of capital / income flows demands appropriate international cooperation by governments everywhere to make sure relevant information is available to them to raise taxes in accordance with their laws. This submission is made by the HK branch of STEP.
  
2. It is in the architecture of international tax information cooperation agreements where government's rights to access reportable tax information conflict with the rights of individuals to appropriate protections to their privacy rights to ensure that their personal information is not abused to their detriment. Ultimately, it is a

question of whether these new government rights to tax information via its automatic exchange (i.e. CRS) are justified in the circumstances.

3. STEP submits that for the following reasons CRS as proposed for Hong Kong ("HK") in the IRO Amendment Bill 2016 ("the Bill") before this Council is simply not justified. However, STEP believes that with some straightforward changes, as outlined below, it can be so justified.
4. This submission will use terms and abbreviations used in the FSTB's Consultation Paper on AEOI.

### **B. The Problems With CRS As Proposed**

#### *The nature and extent of the reportable information*

5. CRS (as regards HK) would see the collection, aggregation, storage and exchange (annually, automatically) of very detailed financial information of HK taxpayers who bank / invest abroad and anyone who banks / invests in here with residence status in a relevant jurisdiction This information would consist of end-of-the-year balance of all reportable accounts (mostly only with year end balances of more than USD250,000) and the dividends/ interest and other income and gains generated annually by those accounts.
6. Where the account is held other than by an individual (companies, funds, trusts, partnerships and other entities) the rules would see through the relevant entities to their ultimate owners / controllers and, if they are residents in a country with whom HK has a CRS agreement, those ownership details would also be collected, stored and exchanged in addition to the underlying financial data.
7. This highly sensitive and detailed information relating to HK taxpayers who bank / invest abroad is not necessary for the IRD to raise taxes because HK does not tax the foreign-sourced income of its taxpayers. In fact, the IRD is not for that reason, as a general matter, currently empowered under domestic law to demand that

information from HK taxpayers. But CRS would see that information in the IRD's hands through the backdoor of our CRS partners giving it to them. And this would be done without any notice to our taxpayers.

*Dangers of loss or abuse of that information*

8. This detailed information of HK people is currently not gathered or aggregated by foreign financial institutions or foreign governments in the way CRS would see it done. Most places do not tax foreigners on these types of investments so, whilst the information is, in some form, in the hands of the FI's, it is not now aggregated and given to the tax authorities automatically. CRS would, in fact, provide to the individual foreign tax authorities an aggregated / consolidated profit and loss account of all reportable investment holdings of each Hong Kong person held in that jurisdiction. It would also provide to the IRD that same information but consolidated on a global basis so that the IRD would see each year a full picture of all HK resident's investment/bank accounts held across all CRS partner jurisdictions. Never before would HK people have had so much of their sensitive data gathered, aggregated and sent to the IRD (or indeed anywhere else) without them even knowing what that data was thus denying them the opportunity to correct any incorrect information.
9. This information in the wrong hands (of which there is no shortage) will expose our citizens to a range of negative impacts ranging from mere embarrassment, to identity and property theft, blackmail, extortion and, worst of all, the kidnapping of their children.
10. With the best will in the world, this detailed financial information is simply not capable of being adequately protected. Historical experience shows that the accessible nature of digitized information and the frailties of the human condition together guarantee that indeterminable amounts of this data will be lost or abused by one or more of its gatherers, storers or exchangers. Nothing in this world is surer. HK has of course had its own recent experience with the VTech scandal. In 2015, the

US alone witnessed 781 major data breaches as tracked by the Identity Theft Resource Centre ([http://www.idtheftcenter.org/images/breach/DataBreachReports\\_2015.pdf](http://www.idtheftcenter.org/images/breach/DataBreachReports_2015.pdf)). In 2015, 71 breaches of records were recorded by the banking financial service industry, 312 by business, 63 by government and 277 by medical / healthcare businesses. Almost every American was affected by at least one data breach in 2015. As recently as February 9<sup>th</sup> 2016, the IRS disclosed a recent attack on its Electronic Filing PIN application program (on irs.gov) perpetrated by cyber criminals in which a malicious bot used 101,000 Social Security Numbers to successfully access PINs. And all this happened in the country which arguably has the world's most sophisticated data protection system and the most effective sanctions for loss of data. See also [www.informationisbeautiful.net/visualizations/worlds-biggest-data-breaches](http://www.informationisbeautiful.net/visualizations/worlds-biggest-data-breaches).

11. It is impossible to have confidence that this, or worse, will not happen in many of the countries which are on the potential list for HK to exchange data with. It is one thing to have faith in one's own government to keep tax information safe; it is quite another to extend that faith to possibly one hundred other countries, many of which have unstable political systems, questionable judicial systems and lamentable human rights records i.e., they lack the basic governance systems necessary to keep this information safe.
12. As far as the many thousands of foreigners who bank / invest in HK (the world's third most important financial centre) CRS will provide to our CRS partners (via the IRD) similar levels of sensitive financial information. The risk of that information being lost by or stolen from our financial institutions, the IRD, or the foreign governments once they get it, cannot be under-estimated. CRS as proposed offers little or no real meaningful protection of this information; nor could it in reality. CRS contains no meaningful sanctions for those who lose or abuse the information.

*The necessity of CRS as proposed*

13. Whilst STEP recognises in para 1 above the necessity of international cooperation in gathering the tax information of citizens everywhere, we question whether CRS as proposed is really necessary (see further below at paras 17 & 18). This is because the OECD and the governments represented by it have already all but won the war on cross-border tax cheating. A raft of new tax information exchange treaties (HK has 34 CDTA's and 7 TIEA's all on request - not automatic) the criminalisation of helping tax cheats in any way and the opprobrium and fines heaped on financial institutions caught at this game (think UBS, Credit Suisse, HSBC and many others) has completely and rightly made tax cheating toxic for all concerned. There are no "weapons of tax destruction" out there anywhere, anymore. There remains a toxic legacy of old tax-cheating money which is being cleaned up by tax amnesties. This process will be much assisted by a CRS modified as we suggest below (see para 18). CRS can therefore be seen as taking a sledgehammer to an already cracked nut.

#### *The American Loophole*

14. Finally, there is a gaping loophole in CRS- the largest financial system in the world, the USA. If non-US taxpayers choose to put their offshore funds into US entities which bank with US located banks (this can be done without attracting US taxes) there will be no CRS reporting because the US refuses to sign up to CRS. One reason is that the US has its own global (essentially non-reciprocal) system for tracking down its citizens who try to cheat US taxes by putting their assets abroad, namely, FATCA. See the attached recent article in The Economist which deals with this very issue. Another reason is the lack of political will in the US to allow CRS type information to be sent automatically from the US to places like China, Russia and Mexico. It is also of interest that Taiwan has not signed up to CRS.

15. This will inevitably mean sensible non-resident customers of our FI's (and those everywhere) will look very closely at moving their business to the US, as will locals who now bank abroad. The USA is already the biggest depository of offshore money in the world (both tax compliant and otherwise) and it stands to benefit hugely by being the most important finance centre not to sign up to CRS.

### **C. Summary**

16. In summary, CRS as proposed will see HK actively participate in a global exercise in mass-surveillance of the sensitive financial information of hundreds of thousands of innocent people around the world with all the negative consequences ( both intended and unintended ) that will inevitably flow from this. This is so even though HK does not require the reportable information on our own taxpayers; when there are no meaningful ways to protect the gathered and exchanged data nor sanctions for its loss or abuse; when the necessity of CRS at this stage of the war on tax cheats is questionable; when the costs of implementing CRS regulations (which will be very significant) will undoubtedly be passed onto customers; when it will potentially severely damage our attractiveness as an international finance centre; and when there is the massive US loophole in CRS.

### **D. What LEGCO Can and Should Do**

17. If HK chooses not to require our CRS partners and their financial institutions to gather and provide the reportable information to the IRD on our own taxpayers, the potential dangers to HK citizens will be much reduced. Our CRS partners should have no argument with this. HK chose the non-reciprocal path with FATCA and there is no reason why it could not do so with CRS. Paragraph 2.35 of the FSTB's Consultation Paper foresees that the IRD will exchange data that will "only involve those persons who may be subject to taxation in their home jurisdictions". HK residents are not subject to tax here on offshore investment income so it should be a simple matter for HK to ask its CRS partners to act the same way to towards HK taxpayers. In fact we submit that HK should go further and ensure that our CAA's with CRS partners do not require their FI's to collect data on HK residents and send it to their tax authorities. There is simply no reason why HK should unnecessarily expose its citizens to the real risks of loss of this sensitive data by creating unnecessary pools of it.

18. On HK's side we submit that it should restrict the information of non-residents it forces FI's here to gather and report to the IRD and exchange with our CRS partners ***to the fact that a resident of country A has a reportable account here***. If HK did this the following would result. Taxpayers around the world would be on notice that their tax authorities know that they maintain reportable accounts here. This would act as a powerful incentive to the remaining non-compliant foreigners who bank/invest here to come clean with their governments or go elsewhere and to discourage new account holders from seeking to use HK to cheat on their home taxes. In addition, foreign tax authorities would have the information necessary to use the existing exchange of information provisions to request greater detail if they needed to. This is a positive development which would breathe new life into the existing exchange of tax information treaty network. And this would be done without having the detailed financial records of many thousands of innocents career round the ether unchecked and at the mercy of those with bad intentions. These on-request information flows would at least be targeted at those with questions to answer and be capable of being properly monitored.
19. These suggested changes, it must be said, are unlikely to be greeted with much enthusiasm by the OECD and some CRS partners because many of them have already (see para 20 below) passed their own implementing regulations. They would fear, rightly, that they might lose business to HK because it would be seen, not as a place to cheat taxes, but as a responsible international finance centre that had a genuine interest in the privacy rights and welfare of those who choose to bank/invest there. There is mention in the FSTB's Consultation Paper that HK wishes to avoid being labelled as an "uncooperative" jurisdiction and that is surely the desired outcome. If HK genuinely embraces the spirit of CRS (but not necessarily every detail of the 100 pages of the Bill as prescribed by the OECD) and were the subject of criticism or worse, the threat of sanctions, the question of who actually exercises sovereignty over HK's tax laws would be bought into sharp relief. It should also be remembered that the HK Government has made it very clear to potential CRS

partners that its agreement to participate in CRS as proposed was wholly conditional on getting Legco approval of the Bill now before this Council.

20. STEP submits that this Council, by adopting the changes proposed above, can sensibly mitigate the inherent dangers of CRS as proposed and limit the damage to our reputation as a responsible international finance centre without HK abrogating its international responsibilities to assist foreign governments in the on-going war on tax cheats.

21. This Council, unlike many other CRS jurisdictions who have already passed the implementing regulations via bureaucratic diktat, retains genuine legislative sovereignty over this critical matter. We urge this Council to exercise its powers in the overall interests of Hong Kong and its people.

### ***E. Technical Amendments***

22. There are numerous technical issues with the legislation (most of which are summarised in the attached STEP CRS Guidance Note) on which we wish to reserve our right to comment. However, we think the majority of these will fall away if the changes we recommend are adopted.

**William Ahern**

**For and on behalf of the STEP HK Legislative Committee**

**Hong Kong February 23<sup>rd</sup> 2016**



