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20 September 2002

Hon. Eric Li Ka-cheung, JP
Chairman,
Bills Committee on the Inland Revenue (No.2) Bill 2001,
Legislative Council,
Legislative Council Building,
8 Jackson Road,
Hong Kong

Dear Mr. Li,

Inland Revenue (Amendment) (No. 2) Bill 2001

We write in response to the letter dated 15 August 2002 from the Bills Committee inviting our views on the Inland Revenue (Amendment) (No. 2) Bill 2001 (the "Bill"), which aims to provide the necessary legal framework for the use of passwords and telephones in furnishing tax returns.

The Society would like to express its support in principle for the initiative of the Inland Revenue Department (IRD) to encourage the greater use of electronic services as a move to promote e-Government and e-Commerce in Hong Kong. However, we have some concerns about certain aspects of the Bill, namely, the interface of the Bill with the Electronic Transactions Ordinance (ETO); the lack of provisions in the Bill prescribing the technical and legal infrastructure to support the proposed new form of e-filing; the proposal to treat the submission of a tax return through the use of a password as the legal equivalent of signing a return, as well as the adoption of certain terminology and concepts.

As you may be aware, when the Bill was gazetted in November 2001, the Society raised a number of issues on it. These related broadly to (a) the overall legislative framework (principally the decision to not to amend ETO instead of or as well as the Inland Revenue Ordinance (IRO)), (b) the system design, operation and security supporting the use of passwords (e.g. issues of

authentication of the sender and integrity of documents sent), (c) legal responsibilities and liabilities (e.g. equating in law the use of a password to signing a return and the related questions of non-repudiation and responsibility for discrepancies) and (d) concepts and terminology (such as the appropriateness of referring to “affixing” a password to a tax return and passwords having to be “approved” by the IRD).

We entered into a correspondence with and met the Commissioner of Inland Revenue (CIR) to discuss these points, as a result of which the Society felt more comfortable in relation to the technical issues, such as the security and integrity of the specific system proposed by the IRD for transmission of data, and the ability of the system to minimise the risk of breaches. At the same time we noted that the infrequent use of, say, a 9/10 character password would make it more likely that a taxpayer would write the password down, which would render the system more open to abuse at the taxpayer’s end. In a further reply to the Society, the CIR indicated that taxpayers would be able select their own passwords and that the Department intended to launch an Interactive Tax Enquiry Service which would be accessible through the same password. Consequently, passwords could be used more often than once a year to submit a return. While we agree that this might make it easier for taxpayers to remember their passwords, we do not think that it would remove the risk of abuse entirely.

--- A copy of the Society’s second letter to the CIR, dated 4 January 2002, is attached for the reference of the Bills Committee. The CIR replied to this on 11 January 2002 but, nevertheless, we remain doubtful in relation to several issues raised in our letter and these are outlined further below.

Electronic Transactions Ordinance v Inland Revenue Ordinance

The Society is of the view that the Bill extends the possible methodologies for effecting e-transactions in a general way. Providing for the use of passwords instead of digital certificates is a change of a qualitative nature in the way that electronic transactions can be conducted, albeit that in this case it is intended to be applied only in relation to tax returns, and as such we believe that this should be provided for in the ETO, whether or not it is specifically provided for in the IRO. As we explained in our letter of 4 January 2002, the ETO was intended to provide a statutory framework for conducting by electronic communication commercial and other transactions. So as

not to constrain the development of e-commerce, the Legislative Council Brief on the Electronic Transactions Bill indicated that “the Bill should adopt a technology-neutral approach to cope with rapid technological changes”. The explicit aim of the present Bill, to make the IRO “self-contained”, therefore, seems to be at odds with the original concept of the ETO and it is likely to cause confusion - because the public will be uncertain where to look to ascertain what forms of e-commerce have legal backing in Hong Kong - as well as undermining the broad aim and intention of the ETO.

While we note the view of the CIR, that section 14 of the ETO provides that if an Ordinance contains an express provision in relation to accepting electronic records, the ETO will not be construed as affecting that provision, we believe that the function of this should primarily be to ensure that there are no inadvertent legal conflicts between different pieces of legislation, rather than to serve as an invitation for new legislation to deviate from and/or extend the framework prescribed under the ETO without reference to the ETO. If it were otherwise, the ETO could in time become no more than a “Digital Signature Ordinance”.

Legal framework for passwords and telefiling

In addition, the ETO provides a framework dealing with various legal and system-related matters to underpin the use of digital signatures through the “public key infrastructure (PKI)”. This is not necessarily provided in specific legislation. The ETO framework covers matters such as the use of a “trustworthy system” by a recognised certification authority, “reliance limits” and compliance reporting. During the passage of the ETO, the Government explained the rationale behind introducing this framework, which was “to take action to address public concerns about the security and certainty of electronic transactions, e.g. the legal status of electronic records and digital signatures, authentication of the parties to electronic transactions, the confidentiality and integrity of electronic messages transmitted over open communication networks and non-repudiation of electronic transactions. To provide a secure and trusted environment for the conduct of electronic transactions....” (see the Legislative Council Brief on the Electronic Transactions Bill).

For the same reasons, it would be desirable to introduce similar legal framework for other methods of authentication, e.g. password and telefiling, to benchmark the types of system integrity required and risk assessment criteria. Although, the proposed system to be adopted by the IRD for the use of passwords may, in practice, from the technical point of view, offer a reasonable level of security and integrity, in the absence of any specific legal backing for the system requirements, taxpayers cannot enjoy a similar level of assurance and confidence as under the PKI system, but rather he or she will just have to take this on trust.

Non-repudiation

The CIR indicated in replying to the Society that the proposed arrangements under the Bill adopt a risk-based approach and that the security and integrity of the proposed system is commensurate with the risk associated with that operation. While this may be a reasonable approach in principle, it begs the question of who is taking the risk? As regards the issue of non-repudiation, the Bills addresses this by amending section 2 of the IRO so as to equate “the act of signing a return” with “the adopting of a password....for the purpose of authenticating or approving the return”.

Thus, as we point out in our letter of 4 January 2002, under section 51(5) of the IRO, a taxpayer furnishing a return electronically will be deemed to be cognisant of the contents thereof and in the event of any discrepancies, the burden will fall on the taxpayer to prove that the return has been altered during transmission, if this is the case, or that he or she did not submit it. Given the inherent vulnerability of a system based on passwords rather than digital certificates (as under the PKI), this could put the relatively unsophisticated taxpayers, who are likely to comprise the bulk of the users of the system, at a disadvantage. In other words, the Bill resolves the question of non-repudiation by giving the IRD the same level of legal protection as if the taxpayer had submitted a paper return. We have some doubts as to whether in principle this is equitable to taxpayers who will be much less familiar with the full implications of electronic filing. We also believe, given the relative inexperience of the courts in dealing with disputes involving electronic transactions, that this could create uncertainty.

One of the critical issues therefore will be to what extent will taxpayers be made aware of and understand the issues of responsibility and liability, particularly given the fact, alluded to above, that there will be little in the way of legal backing to give them confidence in the quality and reliability of the system.

One further related point that we should like to make before leaving this subject, is the question of the operational limits of the system. This may be especially relevant in relation to telefiling but it is also relevant to internet filing. It will be recalled that earlier this month, complaints were expressed over the apparent inability of the telecommunications network to deal with the volume of calls made when the No.8 typhoon signal was raised. It is likely, given the limited number of deadlines for tax returns to be submitted, that the relevant system will have to handle a huge volume of traffic within a relatively short period. In the event of system failure or long delays leading to returns being received beyond the deadlines or not at all, where will the responsibility lie? It should be noted that no assurances have been given as regards the ability of the system to deal with these potential surges of filing activity.

Terminology and concepts

The final issue that we should like to draw to the attention of the Bills Committee concerns the use of certain terms and the concepts that these reflect. We pointed out in our letter of 4 January 2002 that references in the Bill to the CIR “approving” a password, as well as to certain other terms, seemed to us to be inappropriate, and we suggested that they be reviewed. As regards the “approval” process, this appears to amount to the CIR confirming that a particular password selected by the taxpayer conforms to certain minimum security and other requirements. If so, the legislation should reflect this more precisely rather than creating the impression that approval is required for the specific content in addition to the format of the password.

Whilst the concerns mentioned under this heading may not be as significant as the other matters discussed, we consider that the legislation, in assisting in the promotion of e-Government and e-Commerce, which the CIR has indicated is one aim of the Bill, should avoid creating or perpetuating an ambiguous and potentially misleading conceptual framework.

We acknowledge that since the Society wrote to CIR in December 2001 and January 2002, the Information Technology and Broadcasting Branch of the Commerce, Industry and Technology Bureau has commenced a review of the ETO, in the context of which public consultation has been carried out. It is possible that some of the issues that we have raised relating to the interface between the ETO and the IRO and other specific legislation, will be addressed as a result of this review. We certainly hope that the opportunity will be taken to do so.

We hope that you find the Society's views on the Bill to be constructive. If you have any questions on them please contact the undersigned in the first instance.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Peter Tisman". The signature is written in a cursive, slightly slanted style.

PETER TISMAN
DEPUTY DIRECTOR
(BUSINESS AND PRACTICE)
HONG KONG SOCIETY OF ACCOUNTANTS