ACCA 香港分會
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財政預算案建議

ACCA Hong Kong's
Budget Submission
2012/13

ACCA

EXECUTIVE SUMMARY

Hong Kong's future economic prospect is uncertain given the impact of the global financial tsunami. In order to respond to any downside risk, Hong Kong has to seize any opportunity to enhance its competitiveness in order to meet any challenge facing our economy. In doing so, ACCA Hong Kong agrees to the financial management philosophy of maintaining a low tax regime and strictly controlling recurrent government expenditure. Hong Kong's economy should be market driven, but supported by the facilitator role of the Government.

As such, ACCA Hong Kong reiterates the following tax related recommendations to create a level playing field for business of all sizes and all types:

- Group loss relief
- Loss carried back
- To revisit the current practice under section 39E of the Inland Revenue Ordinance (IRO) of disallowing depreciation allowances on certain plant and machinery used outside Hong Kong
- To equalize the interest payable upon settlement of objection cases

We also suggest that the Government should periodically review the cost effectiveness of each policy bureau. Despite that public expenditure is always targeted at a level not exceeding 20% of Hong Kong's Gross Domestic Product (GDP), we suggest that this level of 20% be reviewed from time to time in order to adhere to the fundamental principle of "Big Market, Small Government".

Our other recommendations seek to complement the National 12th Five Year Plan in respect of the development of the industries where Hong Kong enjoys its competitiveness, namely financial services, creative industries and regional centers. In this regard, the proposed measures include:

- Incentives for regional headquarters / service centres;
- Incentives for research and development related expenditure;

- Exemption for income earned from the use of intellectual properties outside Hong Kong; and
- Restoring the rate of deemed assessable profits on royalty payment to non-residents to 10%.

These echo the Chief Executive's recent Policy Address in that favourable industry specific policies follow the principle of "capturing opportunities and capitalizing on strengths".

To enable the society share the fruits of prosperity, as well as to prepare them to face any possible economic threats, ACCA Hong Kong also proposes the following:

- To set out a long term plan to help stabilize the property market;
- To widen the income bands for progressive rates under salaries tax;
- To remove the time limit for the claim of home loan mortgage interest;
- To remove the restriction for married person in electing personal assessment;
- To allow a tax deduction for the premium of medical insurance, capped as $12,000 per year of assessment;
- To allow a tax deduction for the voluntary MPF contribution; and
- To align the residence requirement for the claim of dependent parent allowance (and dependent grandparent allowance) to that of the monthly Old Age Allowance.

Hong Kong is undoubtedly facing the economic challenges ahead in the post tsunami period. To ride on the wave of change, the Government needs to help maximize Hong Kong's strengths. ACCA Hong Kong believes its proposals are practicable in achieving this goal.

PROPOSALS

1 Strengthening the Economy

1.1 Favourable general business environment

ACCA Hong Kong agrees to the basic principles of "Market Leads, Government Facilitates" as well as "Big Market, Small Government" in administering Hong Kong. The government should always play the role of a facilitator in the economic development. As suggested by the Chief Executive in his 2012 Policy Address, macro planning, market intervention and favourable industry-specific policies should strictly follow the principle of "capturing opportunities and capitalizing on strengths".

Along these fundamental principles, ACCA Hong Kong considers that the Government should play an important role to ensure a fair and competitive taxation system, which has always been one of Hong Kong's strengths with that ensure an open and cost effective business environment can be ensured. From this perspective, we have the following recommendations.

1.1.1 Group loss relief

ACCA Hong Kong reiterates its proposal for group loss relief. Many local as well as overseas investors establish separate operating companies under one or more holding companies for various commercial reasons, such as limitation of liabilities, establishment of different reporting lines and holding of accountability on operation results. These group companies are effectively arms or divisions of a central unit. To achieve an equitable tax basis, the taxation of these group companies should be treated as a single entity so that losses of one company can offset the taxable profits of another company within the same group. As tax losses can be carried forward without any time limit for setting off future assessable profits, the introduction of group relief only creates a temporary timing difference in tax revenue collection. This proposal will also align Hong Kong's tax system with that of other major jurisdictions around the world and regional competitors where similar relief exists.

1.1.2 Treatment of tax loss

We also reiterate our recommendation that tax loss of a business be allowed to be carried back to set off against the assessable profits in the preceding year. This will provide certain cash flow relief to loss making companies and encourage profitable operations to invest in new projects which do not immediately generate profits. It will also encourage a business enterprise to reinvest its profits in new plant and equipment as the depreciation allowances thereon may produce a tax loss in the year of investment and the carry-back of such loss will provide an incentive in the form of tax refund for the preceding year.

Currently unrealised gain on trading securities and properties is taxable at the time the gain is recorded. Taxpayers in some cases may eventually end up with actual losses at the time of disposal. Although losses suffered may be carried forward, it is not possible to set off the ultimate losses against the unrealised gain that was subject to tax earlier. Allowing tax loss to be carried back rectifies the unfairness caused by taxing unrealised gain.

1.1.3 Treatment of plant and machinery used outside Hong Kong under section 39E of the IRO

ACCA Hong Kong is concerned about the current practice of the Inland Revenue Department (IRD) disallowing depreciation allowances on plant and machinery used by Hong Kong companies in their import processing arrangements in the Mainland under section 39E of the IRO.

Although we are aware that there were much debate on this topic and it has been concluded that the law would not be relaxed, this practice indeed has brought pressure to a number of businesses with manufacturing operations in the Mainland, in particular to the small and medium enterprises (SMEs). In the 2012 Policy Address, the Chief Executive also acknowledged the possibility of SMEs facing difficulties when the economy faces greater downside risks next year and promised to introduce necessary measures to tide them over. We therefore consider it worthwhile to revisit the current practice.

ACCA Hong Kong strongly feels that the current treatment of the IRD denying the depreciation allowances for those plant and machinery is not in accordance to the original legislative intent nor is it in line with the general tax principle of taxation of allowing deductions of expenses incurred in the production of chargeable profits. We reiterate our view that the Hong Kong government should revisit the issue and consider actions to resolve the difference in opinion.

1.1.4 Cost of acquisition of trademarks, patents and copyrights

Six industries where Hong Kong enjoys its clear advantages were identified by the Government to foster economic diversification, one of which being the creative industry. To promote the wider application of intellectual property by enterprises and the development of creative industries, it was proposed in the 2010/11 Budget that deduction be extended to cover acquisition of registered trademarks, copyrights and registered designs.

We note that the Inland Revenue (Amendment) (No.2) Bill 2011 was passed on 7 December 2011 to introduce profits tax deduction for capital expenditure incurred on the purchase of copyrights, registered designs and registered trademarks. However, the new tax provision confines the deduction to those licensed IPRs that are used in Hong Kong. This means a Hong Kong company which acquires an IPR but license the use outside Hong Kong will be unable to get the deduction under the new legislation, even if the IPR is developed by the Hong Kong creative industries. In addition, the owner of a relevant IP which uses the IP to produce goods through sub-contractors outside Hong Kong, which is a common arrangement in Hong Kong, may also be disallowed to claim the deduction of the cost of the IP on the ground that it is not used by the owner but by someone else (the sub contractor) under license outside Hong Kong. This situation is similar to the denial of depreciation allowances on plant and machinery under the existing section 39E as mentioned above.

ACCA Hong Kong hence considers that the new legislation will not provide any incentives to achieve the original objective of enhancing the development of creative industry in Hong Kong. As such, we propose that detailed guidelines be released to provide a more reasonable and fair interpretation of the legislation in case the wordings of the legislation cannot be modified at this stage.

1.1.5 Advanced pricing arrangement to facilitate multi-national companies' cross-border operations

ACCA Hong Kong appreciates the Government's continuous effort of expanding its tax treaty network. Double taxation treaty can facilitate cross-border activities which are not confined to the transfer of goods and materials, but evolve in variety sophistication. These activities may involve allocation of income among parties in different jurisdictions, and double taxation can arise where, despite the existence of treaty, full relief from double taxation is not available. One of the possible causes is the different views on transfer pricing by the concerned tax authorities.

ACCA Hong Kong recommends that the government should impose a policy to empower the Inland Revenue Department to enter into bilateral / multi-lateral advance pricing arrangements with Hong

Kong's tax treaty parties to help Hong Kong companies enjoy the real benefits of tax certainty for their cross-border economic activities.

1.1.6 Equalising the interest payable upon settlement of an objection

At the moment if an assessment is objected to and the tax heldover with the condition of the purchase of tax reserve certificate, then if eventually the taxpayer receives a refund from the tax reserve certificate, interest is paid to the taxpayer on the Tax Reserve Certificate at the rate of 0.0433% since January 2010.

However, if the tax is unconditionally heldover and eventually the taxpayer has to pay all or part of tax in dispute, interest is charged at the judgement debt rate of the High Court, currently at 8%, which has not been revised since 2009.

Not only that, but if no tax is heldover and eventually the taxpayer is entitled to a refund of all or part of the tax in dispute, no interest is paid to the taxpayer in respect of the tax overpaid, notwithstanding the possibility that it could be years later.

This is obviously a state of inequity to be addressed. ACCA Hong Kong suggests that the interest rate be uniform across all instances, whether it is on the taxpayer or on the IRD. To ensure a fair tax system, tax on the tax reserve certificate, on tax unconditionally heldover, and on tax refunded to the taxpayer should all bear interest at a uniform rate.

We utterly fail to see the rationale for what is now a deliberately skewed playing field in favour of the Government. A uniform rate of interest will ensure neither the taxpayer nor IRD would play the system to their advantage.

1.2 Incentives for industries crucial to Hong Kong's economy

The National 12th Five-Year Plan explicitly supports the development of industries where Hong Kong enjoys competitive advantages.

To complement the 12th Five-Year Plan, especially to support the development of the Great Pearl River Delta including Qianhai, we put forward the following suggestions to accord incentives or tax concessions to designated industries.

1.2.1 Tax deduction for research and development related expenditure

As Hong Kong moves further up the value chain, the creation of intellectual property will obviously become increasingly important. Further tax reliefs can help to encourage Hong Kong businesses to develop intellectual property. Research and development is obviously a key contributor to the success of such development. To encourage business to invest in significant research and development activities, we suggest a super deduction of 200% for qualifying research and development expenditure to promote the development of brand name, high tech products and products with significant intellectual property content.

1.2.2 Exemption for income derived from use of intellectual property outside Hong Kong

Under the principle established in various cases, income derived from intellectual property owned by a Hong Kong company but used outside Hong Kong is subject to Hong Kong profits tax. The same view is taken by the IRD in the revised Departmental Interpretation and Practice Note 21. We recommend that in order to develop Hong Kong into an IP hub, a concessionary tax rate should be given for this income.

1.2.3 Incentives for regional headquarters / services centres

To strengthen Hong Kong's competitive edge in attracting foreign investors to establish regional headquarters or holding companies, ACCA Hong Kong reiterates its proposal to provide concessionary tax rates (e.g. half rate) for regional headquarters' activities which are of a substantial scale and are of the nature of investment, general management, financial management, and marketing with a broad geographic coverage. Given Hong Kong's proximity and close connection to the Mainland, foreign investors would be more willing to set up their regional headquarters in Hong Kong in serving their investments in the Mainland should the same tax incentives be available in Hong Kong.

1.2.4 Tax exemption for certain offshore fund management business

Under the existing offshore fund exemption regime, transactions in shares or debentures of, or rights, options or interests (whether described as units or otherwise) in, or in respect of shares or debentures of, "private companies" are not covered by the tax exemption under section 20AC of the IRO as they are specifically excluded from the scope of "specified transactions". That means a non-resident person engaging in such transactions will not be able to enjoy the exemption from Hong Kong profits tax for profits derived from its entire investment (and not just profits derived from its investment in private companies). This has long been a concern of the private equity fund industry as it is a common commercial practice for private equity investors to use a special purpose vehicle ("SPV") incorporated outside Hong Kong (e.g. a SPV incorporated in Cayman Islands) to enter into transactions in securities including "private companies".

In order to enhance the existing offshore fund exemption regime and further promote Hong Kong as a regional asset management centre, in particular a private equity fund market, we propose that the current definition of "securities" in Schedule 16 of the IRO be amended such that transactions in respect of shares and debentures, etc. of private companies (within the meaning of section 29 of the Companies Ordinance), both incorporated in Hong Kong and overseas, are also included as "specified transactions" and covered by the tax exemption.

2 Improving People's Well-being

ACCA Hong Kong recommends the following measures to help achieve the Government's goal of giving people a better life.

2.1 Measures to help stabilize property price

Housing is an issue of great public concern. A stable and healthy development of the property market is fundamental for improving people's well-being. With the introduction of the special stamp duty in late 2010, together with other measures in forestalling the risk of a property bubble, there have been signs of reduction of speculative activities. We suggest that the Government should closely monitor the effectiveness of these measures and at the same time set out a long term plan to ensure a steady and healthy property market in Hong Kong.

2.2 Tax measures to relieve the burden on the middle-income group

The middle income group forms the pillar of Hong Kong's economy as this group contributes to a majority of Hong Kong's tax revenue under salaries tax. Given the contribution of this group to the society, we consider that they should not be ignored no matter when the fruit of prosperity is shared or when help is required when facing possible economic downturn. As such, we recommend the following measures:

2.2.1 To widen the income bands for the progressive tax rates

We recommend that the income bands for the progressive tax rates under salaries tax be widened so that the overall salaries tax burden for the middle-income group could be lessened. This also helps encourage a harmonious society especially when the global economic prospect next year is not optimistic and they cannot benefit from any of those short term measures which are introduced to ease the burden of the grassroots.

2.2.2 To remove the time limit for home loan interest deduction claim

ACCA Hong Kong recommends that the time limit for claim of home loan mortgage interest be removed. Currently, taxpayers are eligible to claim tax deductions for mortgage loan interests incurred on their place of residence, subject to a maximum amount of $100,000 for a total of 10 years of assessment. As the provision was effective since the year of assessment 1998/99, some taxpayers are no longer eligible for such claim although they are still incurring or will continue to incur finance costs on their current and future place of residence. In line with the general policy of improving the quality of life, the proposed measure could help taxpayers, in particular the middle-income group, to upgrade their home.

2.2.3 Election of personal assessment

The spirit of personal assessment is to provide relief to persons who are eligible for tax reduction and hence to reduce their tax burden. However under the current legislation, where a married person elects personal assessment, he / she has to be jointly assessed with his / her spouse. Under this circumstance, a married person will not be able to enjoy the benefit of the relief under personal assessment just because of his / her marital status, all things being equal to another individual taxpayer.

ACCA Hong Kong strongly believes that a fair tax system is not only ensured for businesses but also for individual taxpayers. We suggest that the restriction for married persons on the election of personal assessment be removed, i.e. individual taxpayers should be allowed to elect personal assessment on his / her own income regardless of his / her marital status.

2.2.4 Deduction for cost of employing domestic helpers

Nowadays, most couples in Hong Kong need to work in order to maintain their livings and they need to employ domestic helpers to help taking care of their families and children. ACCA Hong Kong suggests allowing a deduction for the minimum wage of $3,740 for 12 months for employing one domestic helper for every year of assessment so as to relieve the burden of the working class especially in view of the anticipated economic downturn.

2.3 Other measures to improve people's well being

2.3.1 Tax deduction for medical insurance premiums

Hong Kong's aging population gives rise to an increasing demand for healthcare services. The capability of Hong Kong's public sector in the provision of healthcare services is therefore subject to increasing pressure. We note that the Government is prepared to implement the Health Protection Scheme (HPS).

Whilst awaiting all necessary legislative procedures for the implementation of HPS, ACCA Hong Kong considers that a tax deduction under salaries tax should be given to taxpayers for their own private medical insurance premiums. This encourages the public to prepare for their own medical care expense and achieves the same objective of the healthcare reform of easing the pressure on the public healthcare services and enhancing the long term sustainability of the healthcare system.

We recommend that the annual allowable deduction be capped at \$12,000 for a single person and at \$24,000 for a married couple.

2.3.2 Tax deduction for MPF voluntary contributions

Apart from the foreseeable demand for healthcare services, we foresee that the society will become increasingly demanding for the provision of social welfare with the aging population. Incentives should therefore be considered to encourage the younger generation to save adequately for retirement. ACCA Hong Kong reiterates its proposal for a deduction of voluntary MPF contributions under salaries tax, subject to a cap at 15% of taxpayers' employment income for both the mandatory and voluntary contributions. This is a proactive approach to better prepare the community to cope with the increasing financial burden arising from aging population.

2.3.3 To align the "residence" requirement for dependent parent allowance (and dependent grandparent allowance) with that of the monthly Old Age Allowance

In the 2012 Policy Address, the Chief Executive recognised the fact that some of the senior citizens want to retire in the Mainland and hence has been finding ways to facilitate and support elderly people to settle in the Mainland after retirement if they wished so.

ACCA Hong Kong has raised the concern about the elderly retiring in China for long as this means taxpayers who maintain the elderly will not be able to claim dependent parent allowance. We suggest that the "residence" requirement for claims of dependent parent allowance and dependent grandparent allowance be amended. We strongly recommend that the proposed change to the "residence" requirement for the claim of dependent parent allowance and dependent grandparent allowance should be aligned with that of the Old Age Allowance which has been relaxed from 240 days to 305 days a year for absence from Hong Kong.

3 Control public expenditure

ACCA Hong Kong fully subscribe to the government's principle of fiscal prudence. To maintain the fiscal discipline, the public expenditure is always targeted at a level not exceeding 20% of Hong Kong's Gross Domestic Product. We understand that public expenditure on education, infrastructure, etc is required to benefit the society as a whole. However, we consider it critical to continuously monitor the level of public expenditure and a mechanism should be in place to review whether there is any room for cost savings in respective sectors such that if the level of 20% could be adjusted downwards under the core principle of "Big Market, Small Government", with a balance to ensure that an appropriation allocation of budget to fulfill the genuine needs in particular sections.

SUMMARY

ACCA Hong Kong believes that a competitive tax system is integral to a sustainable budget. In addition, fiscal policies to be introduced should be congruent with the Government's overall strategic direction and adaptable to the ever changing environment. The above proposals are in line with these fundamental principles which are expected to sharpen Hong Kong's competitive edge and help Hong Kong to rise to challenges ahead.