ACCA Think Ahead

ACCA 香港分會 2021/22 年度 財政預算案建議

ACCA Hong Kong Budget Submission 2021/22

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EXECUTIVE SUMMARY

2020 has been an exceptionally difficult year for the world, and Hong Kong has been no exception. The outbreak of Covid-19 has created unprecedented challenges to our society, affecting almost every aspect of people's life. Travelling is restricted, certain types of businesses are ordered to suspend their operations, people are advised to stay home, gatherings of over two persons in public places are not allowed, etc. According to the Third Quarter Economic Report 2020 released by the Hong Kong Special Administrative Region (HKSAR) Government, though there was some improvement in the third quarter, the Hong Kong economy saw a year-on-year decline of 3.5%. The unemployment rate and underemployment rate in August to October 2020 went up to 6.4% and 3.8% respectively.

The global geopolitical tensions also pose increasing uncertainties for the future of Hong Kong. With the evolving global trade disruption, the looming global economic recession coupled with the political uncertainties and the increasingly fierce competition from our neighbouring countries, Hong Kong is exposed to unprecedented challenges and new risks.

ACCA (the Association of Chartered Certified Accountants) Hong Kong appreciates that the Financial Secretary has already rolled out four rounds of relief measures to support particular industry sectors hardest-hit by Covid-19, as well as small and medium enterprises (SMEs) which are the primary pillar and driving force of Hong Kong's economic development. Apart from the relief measures announced, ACCA Hong Kong urges the HKSAR Government to introduce more far-reaching tax measures to support the community and further relieve the burden on citizens' daily lives brought by the economic recession and global political tension.

To mitigate the negative impact brought about by the ongoing outbreak of Covid-19, we recommend various one-off incentives to help businesses and individuals to weather out the economic hardship:

- Cash out the tax loss for eligible taxpayers;
- Allow tax deduction of donation in cash and in kind by loss-making companies;
- Waive the payment of 2020/21 provisional tax;
- Simplify administrative procedures for the application of instalment for tax payment;
- Waive the surcharge on tax payment by instalments; and
- Offer one-time special Covid-19 allowance of HK$10,000 per person and per dependent.

To alleviate the downward pressure put upon the city's economy and to rebuild the community, ACCA Hong Kong proposes the following measures:

- Introduce two-tier standard rates and widen the income bands under salaries tax;
- Remove the 20-year limit on claiming home loan interest deduction and make it a perpetual deduction;
- Allow dependent to nominate the taxpayer to claim the full deduction of home loan interest;
- Allow a tax deduction for rental expenses; and
- Allow a tax deduction for the wages of domestic helper actually incurred and capped at the minimum wage amount for each year of assessment.

ACCA has long been advocating the importance to enhance Hong Kong's tax competitiveness in order to maintain its position and facilitate its long-term development as an international business centre. In these unprecedented times, it is more crucial than ever for Hong Kong to modernise its tax system and enable a more business-friendly tax environment. ACCA Hong Kong continues to reiterate our proposal of introducing the following measures to enable a fairer and more competitive tax policies:

- Allow tax losses to be carried back;
- Introduce group loss relief so the tax loss of one company can offset

against the assessable profits of another company in the same group;

- Introduce incentives for regional headquarters / service centres in Hong Kong;
- Relax the eligibility of qualifying R&D expenditure incurred in the Greater Bay Area (GBA) under the proposed super tax deduction for R&D expenditure.
- Introduce cash rebate for qualifying R&D expenditure;
- Incentivise locally produced and registered intellectual properties by a lower profits tax rate; and
- Subsidise upskilling of individuals to prepare for the new economy; and
- Expand the tax treaties network and streamline the administrative procedures for taxpayers to enjoy the benefits available under the tax treaties.

Please find below ACCA Hong Kong's budget recommendations in full details. Together with the HKSAR Government, we look forward to supporting the profession, the wider business community and the general public to thrive through these challenging times.

PROPOSALS

1. One-off relief measures to help businesses and individuals

With the outbreak of Covid-19 that bought about devastating social and economic impact, we recommend the following one-off relief measures to help businesses and individuals to navigate the difficult time.

1.1 Cash out the tax loss for eligible taxpayers

In current practice, when companies incur a tax loss for a certain year, the tax loss can be carried forward to offset the future taxable profits in subsequent years. In other words, the taxpayers do not have the cash inflow in respect of the tax assets but they can save up future cash outflow for profits tax liabilities in the subsequent profitable years.

In view of the expected prolonged economic recession and to help improve the cashflow of the companies in need, we recommend a cash refund by the Government of the tax amount in respect of the current year tax loss, calculated by applying the current profits tax rate of 8.25% or 16.5% on the tax loss, but capped at the amount of profits tax paid by the same entity in the last one or two years of assessment or HK$165,000 whichever is lower.

We have long been advocating tax loss be carried back to set off against the assessable profits in preceding years. (please refer to point 3.1 below). While we understand that this will still require discussion and will be a major amendment of the Inland Revenue Ordinance which takes time to implement, as an interim solution, we propose this special one-off measure to ease the cashflow of the taxpayers to survive through the pandemic.

We consider this only a timing difference instead of a loss of revenue to the HKSAR Government as this tax loss of current year will not be carried forward (or backward if suggestion in point 3.1 below is accepted) to offset future (or previous years' if suggestion in point 3.1 is accepted) taxable profits once a tax refund is made. However, this tax refund can significantly improve companies' cashflow and help keep them afloat in difficult times. This measure focuses on and aims at helping originally healthy and profitable businesses which turned into loss due to the pandemic. The short term assistance may put them back on their feet. Our proposal can slow down healthy business closure, which can also be an effective measure to stabilise and ease unemployment.

1.2 Tax deduction of donation in cash and in kind by loss-making companies

According to the Inland Revenue Ordinance (IRO), allowable deduction for donation in cash is limited at 35% of the assessable profits. Donations in kinds are non-tax deductible. In the early stage of the outbreak of Covid-19 when sanitising supplies were insufficient to meet the public demand, many companies and individuals leveraged on their procurement networks to source masks and sanitising products as well as other supplies and donated them to the communities in need. To support these businesses who contributed in fighting the pandemic, we suggest allowing a one-off tax deduction of donations in kinds for anti-epidemic supplies or any other purposes as long as they are related to mitigating the negative impact brought by the pandemic.

We understand that deduction of donation expense is not allowed for tax loss cases. To support those companies which helped the community fight against the pandemic but turned into a loss position for their own businesses, we suggest allowing donation expenses by loss-making companies, capped at 35% of historical assessable profits or HK$700,000 (35% of $2 million profits) whichever is lower. This can demonstrate the HKSAR Government's recognition of the commercial sector's efforts in fighting against Covid-19. Such interim measure can be reviewed after the threat of Covid-19 has been over and be discussed again on whether to transform it into a routine measure.

1.3 Waiving the payment of 2020/21 provisional tax

We understand the Government's concern in considering waiving the provisional tax for the year of assessment 2020/21. We believe the existing holdover mechanism is in place to help those taxpayers who are encountering financial difficulties, and the relief measures of waiving surcharge for applying for tax payment by instalments also helps those taxpayers who are facing cash flow problems.

However, in view of the expected prolonged pandemic and the significant economic downturn, we recommend that the Government consider waiving the second instalment of the provisional salaries and profits tax. In effect, waiving provisional tax payment will only cause timing difference to the government revenue, but can help taxpayers' cash flow, stimulate spending and contribute to the recovery of economy.

1.4 Simplifying administrative procedures for the application of instalment for tax payment

We appreciate the Financial Secretary's announcement of measures to support enterprises and employment. Amongst which is to waive the surcharge on tax outstanding for up to one year for taxpayers in need who applied and obtained approval for payment of tax by instalments. We understand that taxpayers are required to provide certain information for the application, but we recommend that administrative procedures for approving applications should be simplified in order to ensure all taxpayers in need under the prevailing economic condition can be dealt with in an effective manner.

1.5 Waiving the surcharge on tax payment by instalments

Taxpayers having financial difficulties in settling their tax bill on time may apply to the IRD for payment of tax by instalments. A surcharge of not exceeding 5% on the amount outstanding after the due date may be imposed. And a further surcharge of not exceeding 10% may also be imposed on the amount remaining unpaid (including tax and 5% surcharge already imposed) after six months from the due date.

We understand the rationale of this surcharge is to deter taxpayers from abusing the tax payment by instalment scheme. But in view of this exceptional pandemic situation, we suggest waiving these surcharge for one year.

1.6 One-off special Covid-19 allowance of HK$10,000 per taxpayer and per dependent.

To provide stimulation to the economy and to improve the cashflow of taxpayers without significantly draining the government reserve, we suggest granting a one-off special Covid-19 allowance of HK$10,000 per taxpayer and HK$10,000 per dependent of the taxpayer. The lowering of the salaries tax payable by individuals not only can reduce their tax burden, but also demonstrates the Government's care and support to our working population. This one-off special Covid-19 allowance does not increase the personal allowances permanently and hence will not have a long-term significant impact on the revenue of the Government.

2. Supporting the community

According to the Third Quarter Economic Report 2020 recently released by the HKSAR Government, unemployment rate drastically increased to 6.4% with a more significant impact in the consumption related sectors.

ACCA Hong Kong suggests, by making use of the wealth accumulation of Hong Kong's economic growth in previous years, further tax relief measures be introduced to support Hong Kong citizens in facing the anticipated difficulties especially with the adverse impact brought by the global political tension.

2.1 Introducing two-tier standard rates and widening the income bands under salaries tax

ACCA welcomes the introduction of the two-tier profits tax in 2018/19 which helps enhance Hong Kong business-friendly tax environment. To achieve fairness in tax system, we encourage the Government to take a long-term commitment by introducing two-tier standard tax rates for taxpayers paying salaries tax.

Currently salaries tax is capped under section 13 (and section 43 under personal assessment) of the IRO at the standard rate (which is currently 15%) on the net income before deduction of allowances. In order to provide fairness to high income salaries taxpayers, the cap should be changed to 7.5% on the first $2 million plus 15% on the remaining chargeable income (that is two-tier standard rate system in calculating the cap). By implementing the above cap, high income taxpayers will have more tax savings than the lower income taxpayers. Hence to provide a similar tax reduction for the lower income taxpayers, the tax bands should be further widened.

By incorporating the two-tier standard rates at 7.5% and 15% and widening the tax bands for progressive tax rates under salaries tax, those individual taxpayers who are currently not taxed at standard rate will be benefited, and 'fairness' amongst taxpayers paying profits tax and salaries tax could be achieved.

2.2 Home loan interest

Under the current tax legislation, where a property is jointly owned by two taxpayers, each taxpayer is entitled to 50% deduction of the mortgage interest expense irrespective of who is obliged to the mortgage repayments. In reality, there are cases where a taxpayer jointly owns a property with their parents or dependents but bears the whole mortgage liability. And he / she cannot benefit from the interest deduction for the whole mortgage repayments. We suggest that the Government should relax the home loan interest provision and allow any direct dependents who do not have chargeable income to nominate the taxpayer to enjoy the full interest deduction under such circumstances.

Under the current scheme, home owners are only allowed to claim home loan interest deduction for a maximum of 20 years only. This creates onerous obligation of taxpayers to keep track on the number of years that the mortgage interests have been claimed as well as administrative burdens to ensure accuracy of the claims. We suggest removing the 20-year limit and making the home loan interest deduction on a perpetual basis over the term of the loan.

2.3 Tax deduction for rental expenses

The current tax legislation only benefits taxpayers who afford to buy their own properties as home owners can claim deductions for mortgage loan interest under salaries tax and personal assessment. It has been a prolonged complaint by those people who cannot afford to buy their own properties for living. And these taxpayers have to pay high rental expenses without any tax deduction for their rental expenses.

As rental expenses and home loan interest costs are cost of livings of similar nature borne by taxpayers, we are of the opinion that they should have the same tax treatment. We suggest rental payment for taxpayers' dwellings should enjoy the same tax deduction as home loan interest, which can be capped at HK$100,000 per annum.

2.4 Deduction for cost of employing domestic helpers

Nowadays, most people in Hong Kong need to work in order to maintain their living standards especially under the great pressure of housing expenses. It is almost essential for them to employ domestic helpers to take care of their families, including children, elderly parents and / or disabled dependents, in order to free themselves for work. ACCA Hong Kong suggests allowing a deduction equal to the actual wages for employing one domestic helper, capped at an amount equivalent to the minimum wage of the domestic helper for each married couple, single parent, or person with children, elderly parents or disable dependents, for every year of assessment so as to relieve the burden of the middle class.

3. Initiatives to navigate business through economic uncertainties

Amidst the recent outbreak of Covid-19, political turmoil, power struggles among different political parties, disruptive effect of technologies and keen competition from neighbouring countries, the Hong Kong business sector is suffering severely from shrinking demands, reducing profit margin and increasing operating costs. We understand that the Financial Secretary had already announced several rounds of initiatives and relief measures to support small businesses. ACCA Hong Kong believes that the HKSAR Government should ride on this appropriate timing and take a pro-active role to introduce tax measures which help businesses navigate through all the economic uncertainties as well as to enhance its tax competitiveness.

3.1 Allowing tax loss to be carried back

Many businesses in the consumer sector had already closed down during the hit of lockdowns and a number of businesses are also expected to incur significant losses in view of the current economic conditions. ACCA Hong Kong reiterates its recommendation that tax loss of a business be allowed to be carried back to set off against the assessable profits in preceding years. This is in line with a number of international as well as regional tax systems including the United States, the United Kingdom, Canada, France, Germany, Australia, and Singapore. And this is also in line with the suggestion of BEPS 2.0 recommended by Organisation for Economic Co-operation and Development (OECD).

Allowing tax loss to be carried back provides certain cash flow relief to help the loss-making companies survive in bad times and encourage profitable operations to invest in new projects in good times. This is also helpful in driving more investments towards R&D in order to build a conducive eco-system for innovation and technology

3.2 Group loss relief

We also reiterate our proposal for group loss relief to modernise Hong Kong's taxation regime as well as to increase its attractiveness.

As a matter of commercial reality, it is common to have separate operating companies established under one or more holding companies, which are effectively arms or divisions of a central unit. To achieve tax equity, 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.

Under the current tax system, tax losses can be carried forward without any time limit for setting off future assessable profits. Hence a group relief only creates a temporary timing difference in tax revenue collection.

Such a relief will not only help enhance Hong Kong's tax competitiveness as many internationally developed tax regimes and the regional competitors, such as Australia, Japan, Malaysia and Singapore, have already implemented similar measures, it also encourages entities within a group to invest in new R&D activities which may incur tax loss at its early stage of investment.

3.3 Incentives for regional headquarters / service centres

To strengthen the role of Hong Kong as a 'super connector' between China and the rest of Asia, and to create professional employment opportunities brought by the initiative to our next generation, ACCA Hong Kong recommends that the Government considers implementing measures to develop Hong Kong into a regional hub.

To attract China and foreign investments, some jurisdictions in South East Asia, such as Singapore, offers a reduced corporate tax rate of 5% or 10% on income from qualifying activities carried out substantially by global headquarters, including commitments in incremental business spending and creation of professional employment.

The number of regional headquarters in Hong Kong demonstrated a first-time recline in history from its record height of 1,541 in 2019 to 1,504 in 2020 according to Census and Statistics Department whilst there are over 4,000 regional headquarters in Singapore.

To enhance Hong Kong's competitive edge in attracting China and foreign investors, ACCA Hong Kong continues to reiterate our proposal of offering concessionary tax rates (e.g. half rate), coupled with incentives for individual employees / expatriates, 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 geographical coverage. Given Hong Kong's proximity and close connection to the Mainland and the Asian countries along the 21st-century Maritime Silk Road, this incentive would lure more China and foreign investors to set up their regional headquarters in Hong Kong in serving their investments in the region.

3.4 Relaxing the eligibility of R&D expenditure for tax deduction incurred in the Greater Bay Area (GBA)

ACCA Hong Kong appreciates the Government's commitment in supporting the development of technology and innovation. With the introduction of super deduction for qualifying R&D expenditure, it encourages corporations to invest in the development of high tech products and / or products with significant intellectual property contents. Moreover, it encourages entities to employ relevant R&D experts, generating new employment opportunities for our younger generation in this discipline.

However, according to the IRD's interpretation of the current tax legislation, an item of R&D expenditure is only deductible if the related R&D activities are conducted in-house by the taxpayer, or if a payment is made to an approved research institute (under the current tax law) or a designated local research institution. Where the R&D work is outsourced and the expenditure is not paid to an approved research institute / designated local research institution, the expenditure is not eligible for any tax deduction, even though the R&D activities may be conducted by another company within the same group.

As Hong Kong is part of the GBA and the Hong Kong Chief Executive, Mrs Carrie Lam, also encouraged a further integration of Hong Kong economy with that of the GBA in her 2021/22 Policy Address, we recommend the super tax deduction be extended to expenditures incurred and paid to companies or research institutes in the GBA. This not only encourages more investment in the R&D work, but also offers companies greater flexibilities on location and manner of the R&D work is conducted.

3.5 Introducing cash rebate for investments in qualifying activities or assets

The current R&D Cash Rebate Scheme only applies to Innovation and Technology Fund project or a partnership project conducted by the designated local research institutions. Other companies involving in R&D activities may only benefit from the proposed super deduction, subject to the various constraints in the eligibility of the R&D activities.

The result of an investment in R&D may not crystalise in a short period of time. For some companies in their early stage, they may not have sufficient taxable profits to enjoy the super tax deduction of the R&D expenditures. The HKSAR Government should consider introducing cash rebate to designated expenditures in qualifying activities and / or assets including, but not limited to, staff trainings, development of online businesses, acquisition of intellectual properties and investment in IT and automation equipment. This will encourage business to invest in high value-added activities and enhance sustainability.

Alternatively, a cash refund for tax loss incurred at a company's early stage can also be considered. In effect, such a cash refund, a tax loss carried back or a group loss relief, if available, will help provide flexibility for companies with insufficient taxable profits in their early stage to benefit from the incentive. This cash refund and the tax loss carried back should be mutually exclusive and at the taxpayer's own choice.

3.6 Tax incentives for developing local intellectual properties

To help create Hong Kong as the intellectual properties (IPs) hub of the Asian region, ACCA Hong Kong recommends that apart from allowing the super tax deduction of the designated expenditures incurred by companies for the production, creation, registration and acquisition of intellectual properties, income generated from the subsequent exploitation of these intellectual properties should also be subject to a reduced tax rate, i.e. 8.25%.

While the reduced tax rate can help attracting companies to register / hold intellectual properties in Hong Kong, it should be granted only when the relevant research and development works are undertaken in Hong Kong. This is critical to ensure this tax incentive complies with the 'modified nexus' approach endorsed by the OECD.

3.7 Subsidising upskilling of individuals to prepare for the new economy

To support the transformation of Hong Kong businesses to adopt technology, we consider that the working population needs to be upskilled. Most SMEs do not have the resources to sponsor staff trainings on new technologies that are perceived as outside the scope of their businesses.

To upgrade the labour skill sets, ACCA Hong Kong proposes granting cash rebate or subsidy to companies whose gross income do not exceed HK$5 million for providing or sponsoring staff trainings on utilising and adopting technology in enhancing business processes and performance.

In addition, we recommend that the Continuing Education Fund be revamped to allow an annual subsidy instead of a one-off amount for any individual with learning aspirations to pursue continuing education and training, in particular for innovation and technology.

3.8 Expanding tax treaties network

Hong Kong, with its proximity to China, can act as the springboard for China outbound investments through expanding its tax treaty network with various countries. Amongst the 139 countries under the Belt and Road Initiative, Hong Kong currently has only concluded comprehensive double tax agreements with 26 countries, with 11 countries under negotiation. The HKSAR Government should accord priority in the negotiation and consider entering into tax treaties with those other countries currently not on the current list, in particular Hong Kong's major trading partners.

To ensure taxpayers can truly benefit from the tax treaties, we suggest the HKSAR Government to further consider and streamline the implementation details under the tax treaties. For instance, currently there is no guidelines regarding the minimum substance for the issuance of the certificate of tax residence. Each application is assessed individually on a case by case basis. To achieve a more consistent practice so as to provide more tax certainty, we recommend the safe harbour rules be provided by the IRD .

The HKSAR Government should also allocate sufficient resources in the related administrative procedures required.

SUMMARY

Facing a worldwide economic shock in 2020, the Hong Kong economy experienced significant downturn, local GDP contracted and unemployment rate surged to a record height. While the difficult external environment is expected to continue for some time, the utmost pressing job for the HKSAR Government is to lead the society through difficult times. On top of the numerous relief measures which have been announced to support the hardest-hit industry sectors as well as small and medium enterprises, ACCA Hong Kong suggests that further lenient tax measures be introduced to ease the burden of all taxpayers, who have been there to support Hong Kong's salaries tax revenue, which accounts for over 8% of total government revenue.

The HKSAR Government should also play a proactive role to help businesses and the wider community navigate through this unstable economic climate and mitigate the negative impacts brought about by the unprecedented uncertainties. It should ensure Hong Kong always remains vigilant and get Hong Kong well-prepared for combatting external changes and meeting future development needs. Timing and strength of implementation of mitigation measures are also key.

ACCA Hong Kong believes that a competitive tax system is an indispensable part of a good Government economic policy, and budgetary measures are instrumental in driving long-term and sustainable economic development. As such, the proposed tax measures we put forward to enhance Hong Kong's competitiveness follow the directions of improving people's livelihood, supporting enterprises and safeguarding jobs as well as promoting economic development.

While some proposed tax incentives might cause a short-term delay or reduction in revenue, it is advisable that the HKSAR Government shares its wealth accumulation from the previous economic growth with the community during this difficult time. We trust that all our recommendations are for a good cause and will help rebuild confidence in Hong Kong and accelerate business growth and sharpen our city's competitive edge in the long run.