

**ACCA 香港分會  
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**ACCA Hong Kong  
Budget Submission  
2016/17**



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# EXECUTIVE SUMMARY

With the slowing down of economic growth in China, intensifying political turmoil in Europe and the rising interest rate in US, Hong Kong is facing a difficult international economic climate. ACCA (Association of Chartered Certified Accountants) Hong Kong has been long advocating the importance for Hong Kong to strengthen its long-term position as an international financial and commercial center and ensure the continuous provision of a business enabling environment in order to help businesses withstand the challenges ahead.

ACCA Hong Kong had conducted a survey to solicit members' views and recommendations accounting professionals have for the Government to formulate its 2016/17 fiscal budget. The following tax related recommendations, supported by ACCA members, are made for the purpose of ensuring the continuous prosperity and stability of Hong Kong.

While China's One-Belt-One-Road initiative is a mostly discussed and studied topic, in order to help Hong Kong businesses grasp the opportunities therein, ACCA Hong Kong has the following proposals to enhance Hong Kong's competitive advantage in creating itself an investment platform for any funding, financing or supporting all infrastructure projects under the One-Belt-One-Road initiative.

- To expand tax treaties network and streamline the administrative procedures for taxpayers to enjoy the benefits available under tax treaties
- To introduce incentives for regional headquarters / service centres set up in Hong Kong
- To speed up the legislative process for offering preferential tax measures for Corporate Treasury Centres

We also trust that the newly set up Innovation and Technology Bureau can play a role in determining the criteria for any research and development expenditure

qualified for the following proposed incentives:

- Allowing a super deduction for qualifying research and development expenditure
- Relaxing the conditions for claims of qualifying research and development expenditure
- Granting cash rebate to qualifying expenditures

Hong Kong's economy has long been supported by small and medium enterprises (SMEs) and there are about 320,000 SME establishments in Hong Kong. To help SMEs survive through the unstable and uncertain economic environment, ACCA Hong Kong suggests offering concessionary profits tax rate to SMEs.

We also propose to allow a super deduction for plant and machinery used in environmental protection in order to support the conclusions of the Paris Climate Conference and to bring "green finance" into the mainstream.

A competitive tax system is critical to ensure a business enabling environment. We therefore recommend a comprehensive review of our tax system, which should include but is not limited to the following:

- revisit the tax rates under both profits tax and salaries tax;
- remove restrictions on depreciation allowance for aircrafts
- introduce group loss relief so the tax losses of one company can offset against the assessable profits of another company in the same group;
- allow losses to be carried back;
- treat statements of loss in the same way as notices of assessment and finalize the tax loss cases within statutory limitation period;
- widen the income bands under salaries tax;
- adjust personal allowances and consider doubling the married persons personal allowance for the first year of marriage;
- remove the restriction for married person in electing personal assessment; and to
- align the residence requirement for the claim of dependent parent \ grandparent allowance to that of the monthly Old Age Allowance

To the wider community, ACCA Hong Kong has the following proposals:

- Allow a tax deduction for the premium of medical insurance, capped at \$15,000 per year of assessment;
- Allow the dependent to nominate the taxpayer to claim the full deduction of home loan interest
- Allow a tax deduction for the wages of domestic helper actually incurred and capped at the minimum wage amount for each year of assessment

# PROPOSALS

## 1 Business Enabling Environment

In view of the slowing down of economic growth of China and rising of interest rate in US, Hong Kong business sector is experiencing a shrinking demand and increasing operating costs. The Hong Kong Government needs to introduce measures to boost economy. In doing so, ACCA Hong Kong believes that the Government will fulfill its role as a facilitator in the economic development.

### 1.1 One-Belt-One-Road Initiative

With the China government proposing the strategic development framework of The Silk Road Economic Belt and the 21st-century Maritime Silk Road that focuses on connectivity and cooperation among countries primarily in Eurasia and South East Asia region, it underlines China's taking a bigger role in global economic affairs. To ride on Hong Kong's competitive advantage of its physical location, the Hong Kong Government can help business grasp the opportunities by means of the following initiatives.

#### 1.1.1 Implementation details under tax treaties

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 66 countries under this initiative, Hong Kong currently has only concluded comprehensive DTAs with 12 countries. As such, the Hong Kong Government should further consider entering into tax treaties with those remaining countries.

To ensure taxpayers can truly benefit from the tax treaties, we suggest that the Government should further consider the implementation

details under the tax treaties and to streamline the implementation details. The Government should also allocate sufficient resources in the related administrative procedures required.

#### 1.1.2 Incentives for regional headquarters / service centres

To strengthen the role of Hong Kong as the “super connector” between China and the rest of Asia under the One-Belt-One-Road initiative, ACCA Hong Kong recommends the Hong Kong Government to consider implementing measures to facilitate Hong Kong acting as a regional hub. Many jurisdictions in Southeast Asia have enacted tax concessions for regional headquarters to compete for China and foreign investments. To enhance Hong Kong’s competitive edge in attracting China and foreign investors, Hong Kong can consider offering 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 and the Asian countries along the 21<sup>st</sup>-century Maritime Silk Road, such tax incentives would lure more China and foreign investors to set up their regional headquarters in Hong Kong in serving their investments in Asia.

#### 1.1.3 Incentives for Corporate Treasury Centres

Apart from incentives for regional headquarters set-up, incentives should also be considered to encourage set-ups of corporate treasury centres in Hong Kong, as the One-Belt-One-Road initiatives would be advantageous to Hong Kong developing into a treasury hub. This in turn benefits and strengthens Hong Kong’s financial and business sectors, and helps deepen Hong Kong’s capital markets, including the offshore RMB market. Emerging Chinese and Asian multinationals are looking to support international expansion and growth, for whom the

cases for setting up Corporate Treasury Centres are becoming compelling.

ACCA Hong Kong understands that tax rule changes in this regard have been proposed in the legislative council. We therefore urge the Hong Kong Government to speed up the legislative process of passing the proposed tax incentives and the rule changes.

## 1.2 Qualifying research and development expenditure

The Innovation and Technology Bureau was established to develop policies to strengthen support for the innovation and technology sector, improving the linkages among the Government, the industry and academia on the issue, and encouraging private-sector participation. ACCA believes that the newly set up Innovation and Technology Bureau can play an important role in the implementation of the below proposals.

### 1.2.1 Super deduction for qualifying research and development expenditure

Many other jurisdictions provide incentives to encourage innovations such as super rate of tax deduction on the amount of “qualifying expenditure” ranging from 150% to 400%. In order to encourage businesses to invest in significant research and development activities, we suggest a super deduction of 200% for qualifying research and development expenditure. This helps to promote the development of high tech products and products with significant intellectual property contents.

We also propose that the Innovation and Technology Bureau can help determine the criteria for how research and development expenditure can be qualified for this super deduction.



### 1.2.2 Relaxing the condition for tax deduction of research and development expenditure

According to the Inland Revenue Department's interpretation of the current tax legislation, research and development expenditure is only deductible if the research and development activities are conducted in-house by the taxpayer or a payment is made to an approved research institute. Where the research and development work is outsourced and the expenditure is not paid to an approved research institute, the expenditure is not eligible for any tax deduction, even though the research and development activities may be conducted by other companies within the same group. This does not appear to fit the rationale of encouraging research and development as well as the commercial practices. We therefore recommend that any expenditure of qualifying nature as determined by the Innovation and Technology Bureau should be allowed as a tax deduction no matter whether it is conducted in house by the taxpayer or outsourced to a third party or group company.

### 1.2.3 Introduction of cash rebate for investment in qualifying activities or assets

With the setting up of Innovation and Technology Bureau, investments in innovation research and development can be better coordinated. The Government should consider introducing cash rebate to designated expenditures in qualifying activities and \ or assets endorsed by Innovation and Technology Bureau including, but not limited to, staff trainings, development of online business, 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.

### 1.3 Supporting entrepreneurship and SMEs

According to the statistics provided by the Trade and Industry Department, there are about 320,000 SMEs in Hong Kong, which constitute over 98% of our business establishments and employ about 50% of our workforce in the private sector. Their vitality and business performance are therefore of crucial importance to the development of Hong Kong's economy. However, facing the raising business costs and the economic instability and uncertainty, it may now be challenging and difficult for SMEs to maintain their businesses on a sustainable basis.

Singapore government offers concessionary profits tax rate of zero percent for the first S\$100,000 profit and 50% off tax rate on the first S\$300,000 profit for a limited period of time. We recommend that concessionary profits tax rate be given to SMEs with qualifying conditions within a limited timeframe in order to support these businesses and alleviate the financial pressures of SMEs under the anticipated economic difficulty.

#### 1.4 Supporting environmental business

With the conclusion of the Paris Climate Conference, major countries in the world, including China, have committed to investing resources and effort to reduce greenhouse gas emission. Hong Kong can work together with China in contributing to the global low-carbon transition. Hong Kong, being one of the financial hubs of the world, should look into how it can play an important role in financial innovation, thus bringing "green finance" into the mainstream.

Government can encourage scaling up investments in climate smart development projects through offering attractive tax incentives. As an environmental protection initiative, we suggest that a super deduction for tax purpose should be given to businesses for eligible costs of plant and machinery used in environmental protection.

## **2 Comprehensive review of tax system**

Hong Kong boasts its simple-low-tax system being one of the factors that make Hong Kong a successful leading financial and commercial center. However, the last review of Hong Kong's tax policy was done almost 40 years ago. Yet with all the recent changes in international tax regulations and global economic development, Hong Kong needs to conduct a comprehensive review of its tax system to ensure it remains competitive and meets the needs of the society. Undoubtedly, a competitive tax system is crucial in a business enabling environment. ACCA Hong Kong suggests the Government conducting a comprehensive review of tax system, which should include but is not limited to, the following areas.

### **2.1 Revising tax rates under profits tax and salaries tax**

A number of one-off relief and concessionary measures, including but not limited to 75% concessionary reduction of salaries and profits tax, capped at \$20,000, have been implemented for a number of years. Instead of implementing these concessionary measures for a prolonged period of time, we recommend that the Hong Kong Government should consider formalizing these measures and incorporating them into the tax system by revising the tax rates under both profits tax and salaries tax. This would not only allow taxpayers to better plan for their tax liabilities but also demonstrate the Government's commitment in supporting the community.

### **2.2 Removing restrictions on depreciation allowances for aircrafts**

In last year's policy address as well as Budget speech, it was mentioned that the Government would explore measures that can promote the aerospace financial business in Hong Kong. ACCA Hong Kong strongly supports this. We believe Hong Kong is well placed to operate as an aviation financing hub in Asia. However section 39E of the Inland

Revenue Ordinance which only allows depreciation allowances if the lessee is a Hong Kong operator. This restriction should be removed, so as to attract leasing arrangements involving foreign and Mainland airlines to Hong Kong .

### 2.3 Group loss relief

ACCA Hong Kong reiterates its proposal for group loss relief based on the fundamental principle of equity for a good tax system.

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.

However, it enhances Hong Kong's tax competitiveness as many other major jurisdictions in Asia Pacific, such as Australia, Japan, Korea, Malaysia, Singapore and Taiwan, have already implemented similar relieves

### 2.4 Allowing tax losses to be carried back

We also reiterate our recommendation that tax losses of a business be allowed to be carried back to set off against the assessable profits in the preceding year. 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.

Allowing tax losses to be carried back encourages growth and investment as certain cash flow relief is available to loss making companies whilst profitable operations are encouraged to invest in new projects which do not immediately generate profits.

#### 2.5 Finalization of tax loss cases within statutory limitation period

Currently, a statement of loss issued does not constitute an assessment, and hence the 6 year limitation period is not applicable for a statement of loss; the Inland Revenue Department can therefore revise a statement of loss after 6 years. This creates uncertainty to an enterprise in its business planning and unreasonable obligation to keep business records for an indefinite number of years. To add more certainty to a taxpayer, we suggest that a statement of loss should be accorded the same legal status as a notice of assessment. This also helps reduce the onerous obligation of taxpayers to keep business records beyond seven years.

#### 2.6 Widening the income bands under salaries tax

Under the inflationary environment caused particularly by the significant increase in housing expenses, taxpayers effectively have a higher tax burden year after year, in light that the income tax bands remain unchanged. We therefore recommend that income bands for the progressive tax rates under salaries tax be widened in order to lessen the overall salaries tax burden of individual taxpayers. We suggest that the widening of the income bands reflect an inflationary adjustment or be widened to \$50,000.

#### 2.7 Adjusting personal allowances

Apart from widening the income tax bands, we also suggest that personal allowances be increased in order to keep up with inflation.

This includes all the personal allowances such as basic allowance to \$140,000, dependent parent \ grandparent allowance to \$50,000 each and all other personal allowances.

As the living standard of Hong Kong is very high, newly married young couples would have numerous financial expenditures and burdens right before and after their marriages. We suggest doubling the married person's allowance for the first year of marriage to provide some tax relief to the young generation.

## 2.8 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 may not be able to enjoy the benefit of the relief under personal assessment just because his / her spouse is not a permanent or temporary resident in Hong Kong , all things being equal to another individual taxpayer. In addition, where personal assessment is elected, consent of and thus disclosure of tax information to the taxpayer's spouse is required. This is not in line with the practical situation in Hong Kong where spouses are financially independent.

ACCA Hong Kong suggests 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. This also ensures a fair tax system where every taxpayer can enjoy the benefit of relief where available.

## 2.9 Aligning the “residence” requirement for dependent parent \ grandparent allowance with that of the monthly Old Age Allowance

Currently one of the conditions for a taxpayer to be entitled to dependent parent and grandparent allowances is that the parents or grandparents are ordinarily residing in Hong Kong. We strongly recommend that the “residence” requirement for claims of dependent parent allowance and dependent grandparent allowance be amended. We propose to relax the “residence” threshold for the claim of dependent parent allowance and dependent grandparent allowance with reference to that for the Old Age Allowance, i.e. not more than 305 days a year for absence from Hong Kong.

### **3 Supporting the community**

As noted from the figures provided in the 2016/17 consultation package, only 46% of the working population paid salaries tax in 2013/14. However, this population contributed over 11.3% of the government revenue. ACCA Hong Kong suggests that tax measures should be introduced to relieve the burden on this group of people in view of the rising living costs.

#### **3.1 Tax deduction for medical insurance premiums**

There is a clear consensus among the community that aging population is causing increasing pressure on government expenditure for healthcare and social welfare services and hence needs to be addressed. ACCA Hong Kong considers that a tax deduction under salaries tax should be given for private medical insurance premiums so as to encourage the public to prepare for their own medical care expenses in the future. We recommend that the annual allowable deduction be capped at \$15,000 for a single person and at \$30,000 for a married couple.

#### **3.2 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. However, under the current tax legislation, 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.

### 3.3 Deduction for cost of employing domestic helpers

Nowadays, most couples 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 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 \$4,210 per month for each married couple or each single parent situation for every year of assessment so as to relieve the burden of the middle class.

## 4. **Control public expenditure**

We wish to reiterate the importance of constraining public expenditure and balancing the government's budget. Hong Kong has been following the principles of fiscal prudence and needs to keep the budget commensurate with the growth rate of GDP as well as to avoid any fiscal deficit. According to the Government statistics, public expenditure for 2015/16 is estimated to increase by 11.3% over prior year while government revenue remains flat compare to last year. We urge the Government to prioritise government spending so as to utilise



the funds in the appropriate sectors and to support the economic development. A mechanism can be considered to be put in place to review whether there is any room for cost savings, and to ensure that there are appropriate allocations of budget to fulfill the genuine needs in particular sectors.

# SUMMARY

ACCA Hong Kong believes that a competitive tax system is an integral part of a good Government economic policy, and budgetary measures can be used to steer long-term economic development. We understand that some proposed tax incentives will cause a short-term reduction in revenue, but we trust that all of them are aimed at the long term objective to sharpen our competitive edge in steering future business growth. We believe our proposals are sustainable within the current fiscal strength and beneficial to the long term economic development of Hong Kong.