

Think Ahead

ACCA

Professor K.C. Chan
Acting Financial Secretary
Financial Secretary's Office
The Hong Kong SAR Government
25/F, Central Government Offices,
2 Tim Mei Avenue
Tamar
Hong Kong

22 December 2016

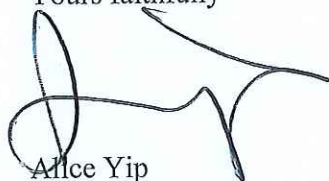
Dear Professor Chan

Budget Submission – 2017/18

On behalf of ACCA (The Association of Chartered Certified Accountants) Hong Kong, we present herewith our budget proposals for the fiscal year 2017/18.

If you or any of your colleagues wish to further discuss our submission, please feel free to contact us at 2973 1108.

Yours faithfully



Alice Yip
Chairman



Kenneth Wong
*Co-Chairman
Tax Sub-Committee*



Danny Po
*Co-Chairman
Tax Sub-Committee*

Enclosures

ACCA



+852 2524 4988



info@accaglobal.com



www.accaglobal.com

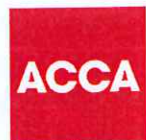


ROOM 1901 19/F WORLD WIDE HOUSE 19 DES VOEUX ROAD CENTRAL HONG KONG

**ACCA 香港分會
2017/18 年度
財政預算案建議**

**ACCA Hong Kong
Budget Submission
2017/18**

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EXECUTIVE SUMMARY

The coming year will be a challenging one for the global economy against the backdrop of unprecedented changes: Donald Trump is set to become the US president; Europe faces key elections and the prospect of a painful Brexit. Closer to home, China's economy is clearly slowing down. Renminbi faces continued downward pressure; and the vote for Hong Kong's next Chief Executive is around the corner. We are facing an increasingly difficult international economic climate, and ACCA (Association of Chartered Certified Accountants) Hong Kong has been long advocating the importance for Hong Kong to strengthen and leverage its long-term position as an international financial and commercial centre, to ensure the continuous provision of a business enabling environment and help businesses ride out the global economic storm.

ACCA Hong Kong polled over 180 Hong Kong-based members including accounting and finance professionals from diverse industries and organisation sizes to solicit their views and recommendations on the Government's 2017/18 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.

The 'One Belt, One Road' Initiative has become the centerpiece of China's economic policy. In order to help Hong Kong's businesses grasp the opportunities therein, ACCA Hong Kong has the following proposals to enhance Hong Kong's competitive advantage by creating itself into an investment platform for any funding, financing or supporting of the infrastructure projects under the Belt and Road initiative.

- To expand the tax treaties and streamline the administrative procedures for taxpayers to enjoy the benefits available under tax treaties;
- To introduce incentives for regional headquarters / service centres

in Hong Kong.

We also propose that the Innovation and Technology Bureau can play a key role in determining the criteria for qualifying research and development expenditure for the following proposed incentives:

- Allowing a super tax deduction;
- Relaxing the conditions for claims;
- Granting cash rebate.

Hong Kong's economy has long been supported by 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.

To support the conclusion drawn from the Paris Climate Conference, ACCA Hong Kong also proposes allowing a super deduction for plant and machinery used in environmental protection in order 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, including but not limited to, the following:

- revisiting the tax rates under both profits tax and salaries tax;
- granting depreciation allowances for aircraft and ship crafts financed by non-recourse debts;
- introducing group loss relief so the tax loss of one company can offset against the assessable profit of another company in the same group;
- allowing losses to be carried back;
- treating statements of loss in the same way as notices of assessment and finalising the tax loss cases within the statutory limitation period;
- widening the income bands under salaries tax;

- adjusting personal allowances and doubling married person's allowance for the first year of marriage;
- removing the restriction for married person in electing personal assessment; and
- aligning the residence requirement for the claim of dependent parent / grandparent allowance to that of the monthly Old Age Allowance.

It is equally important to consider the welfare of the wider community. ACCA Hong Kong has the following proposals:

- utilising the revenue generated from extra stamp duty to support subsidised housing;
- allowing a tax deduction for the premium of medical insurance, capped at 15% of assessable income;
- removing the 10-year limit on claiming home loan interest deduction and making it a perpetual deduction;
- allowing the dependent to nominate the taxpayer to claim the full deduction of home loan interest; and
- allowing 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. Faced with these challenges, ACCA believes that the Hong Kong Government should fulfill its role as a facilitator in the economic development, by introducing measures to boost the economy.

1.1 The Belt and 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 pivotal role in global economic affairs. With Hong Kong's geographical location being favorable and strategic, the Hong Kong Government can help businesses 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 65 countries under this initiative, Hong Kong currently has only concluded comprehensive double tax agreements with 22 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 and streamline the implementation details under the tax treaties. 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 a 'super connector' between China and the rest of Asia under the Belt and Road initiative, and to create professional employment opportunities to our young generations, 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. For instance, Singapore offers a reduced corporate tax rate of 5% or 10% on income from qualifying activities carried out by substantive global headquarters, including commitments in incremental business spending and creation of professional employment.

The number of regional headquarters in Hong Kong has remained static (1,367 in 2012 compared to 1,379 in 2016) over the past 5 years. 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 geographical coverage. Given Hong Kong's proximity and close connection to the Mainland and the Asian countries along the 21st-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.

1.2 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 participation from the private sector. ACCA believes that the 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 or to set up the intellectual properties development hub in Hong Kong, we suggest a super deduction of 200% for qualifying research and development expenditure, including but not limited to, the salaries of research and development staff. This helps to promote the development of high tech products and products with significant intellectual property contents. Moreover, it also encourages entities to employ local research experts and generate new employment opportunities for our young generations in this discipline.

As the Innovation and Technology Bureau has already defined qualified research and development activities that are eligible to government subsidies, we can adopt the same list of expenditures that 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, an item of 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.

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

For some start-up companies, they may not have sufficient taxable profit to enjoy the super tax deduction of the research and development expenditures. 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 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.

1.3 Supporting entrepreneurship and SMEs

According to the statistics provided by the Trade and Industry Department, there are about 320,000 small and medium enterprises (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 rising operational costs and the economic instability and uncertainty, it may now be challenging and difficult for SMEs to sustain their businesses.

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 specified period of time. We recommend a number of measures to alleviate the financial pressures of SMEs under the anticipated economic difficulty, including:

- Zero profit tax rate for the first HK\$300,000 assessable profit during the first three years of operation after incorporation;
- 50% off of tax rate of the fourth and fifth year of operation after incorporation;
- Offer free or low-rental office spaces to start-up SMEs with qualifying conditions within a specified timeframe;
- Increase the banking facilities offer to start-up SMEs guaranteed by government; and
- Increase the funding of SME loans and relax the criteria of applying SME loans.

1.4 Supporting environmental business

With the conclusion of the Paris Climate Conference, major countries in the world, including China, have committed to invest 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 pioneer and lead 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 makes 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, including the implementation of 'Automatic Exchange of Financial Account Information in Tax Matters' (AEOI) and introduction of measures to counter 'Base Erosion & Profit Shifting' (BEPS), 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 consider, but not limit to, the following areas.

2.1 Revise 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 HK\$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 formalising 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 Granting depreciation allowances for aircraft and ship crafts financed by non-recourse debts

Under the current tax system, no depreciation allowance is granted to the finance leased aircrafts and ships if the company is not an operator of a Hong Kong ship or aircraft or the costs of which are financed by a non-recourse debt. This restriction has made Hong Kong unattractive for raising funds to finance the acquisitions of aircrafts and ships.

With China enterprises expanding to overseas rapidly, such as China sells high speed trains to Indonesia and other countries and will start its commercial flight soon, granting depreciation allowances to aircrafts and ships and removing the restriction that the lessee has to be a Hong Kong operator would promote Hong Kong as an aviation finance hub, strengthen Hong Kong's role as the regional financial centre and the largest Renminbi offshore clearing centre.

Government should consider relaxing S39E of the Inland Revenue Ordinance, with appropriate ring fencing measures in place to avoid abuse, to facilitate the exploration of possible business opportunities.

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, such a relief will help enhance Hong Kong's tax competitiveness as many other major jurisdictions around the world and regional competitors, such as Australia, Japan, Korea, Malaysia, Singapore and Taiwan, have already implemented similar.

2.4 Allow tax loss to be carried back

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 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 loss 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 Finalisation 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 taxpayers to keep business records for an indefinite number of years. To add more tax 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, given 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 HK\$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 strongly 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, irrespective of business or individual, 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 2017/18 consultation package, only 52% of the working population paid salaries tax in 2014/15. However, this population contributed over 12.2% 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 Utilising extra revenue from stamp duty to support subsidised housing

The Government has raised the property stamp duty several times in the past three years to tame soaring real estate prices, which should have generated significant unbudgeted revenue. To demonstrate the determination of government to resolve housing issue, the government should clearly quantify this extra revenue and utilise this funding in supporting subsidised housing. This can take the form of building more public housing to accommodate low income groups or providing interest-free loans to first-time property

buyers.

3.2 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 actual expenditure incurred in medical insurance should be fully deductible, capped at 15% of assessable income.

3.3 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.

Under the current scheme, home owners are only allowed to claim home loan interest deduction for a maximum of 10 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 10-year limit and making the home loan interest deduction on perpetual basis.

3.4 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 disable 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.

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 2016/17 is estimated to increase by 11.8% over prior year while government revenue improved by 10.7%. 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 indispensable part of a good Government economic policy, and budgetary measures are instrumental in driving 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 for a good cause and will accelerate business growth and sharpen our city's competitive edge in the long run. We believe our proposals are sustainable within the current fiscal strength and beneficial to the long term economic development of Hong Kong.

