# Tax policy and budget proposals

## 2014-15

Facing Hong Kong's challenges

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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# Tax policy and budget proposals 2014-15
# Facing Hong Kong's Challenges
# Key measures proposed

The Institute's 2014-15 budget proposals, developed by the Taxation Faculty Executive Committee, focus on tax policies and measures on the revenue side of the budget. Under the heading "Facing Hong Kong's Challenges", our recommendations relate to several key areas, including tax policies to attract and facilitate business growth, in addition to introducing budgetary measures to help businesses and the community.

Outlined below are the main measures proposed by the Institute.

## Tax policy

1. Establish a tax policy group within the government to:

    (a) Assess and research Hong Kong's competitiveness and suggest refinements to the tax system.

    (b) Monitor international developments in tax administration and make clear where the government stands on important developments such as the Organisation for Economic Co-operation and Development's action plan on base erosion and profit shifting.

2. Strengthen the transfer pricing regime by providing a legislative framework and more interpretative guidance.

3. Allocate sufficient resources to address expeditiously practical issues arising from the implementation of double tax treaties.

4. Refine the tax system, by making it more certain and competitive and improving the board of review:

    (a) Clarify rules for source of profits by providing more guidance, and codifying the tests for determining source for some specific types of profits.

    (b) Clarify the approach on the taxation of unrealised gains following the court decision in Nice Cheer Investment Ltd. vs. Commissioner of Inland Revenue.

    (c) Make a clear distinction between the treatment of shares as revenue or capital, by regarding them as capital when they are held for a minimum of three years.

    (d) Reduce the statutory time bar for finalisation of tax affairs to three years, and accord a statement of loss the same status as a notice of assessment.

    (e) Introduce group loss relief arrangements.

    (f) Introduce loss carry-back arrangments.

(g) Establish a full-time panel with tax expertise to hear complex Board of Review cases.

## Budget measures

5. Profits tax measures

   (a) For companies whose gross income does not exceed HK$5million, reduce the corporate profits tax rate to 15%, in line with the rate for unincorporated businesses.

   (b) Waive the business registration fee for 2014-15.

6. Asset management and financial services centre

   (a) Introduce exemptions for onshore funds that meet specific criteria.

   (b) Introduce further tax incentives for the insurance sector.

   (c) Introduce stamp duty exemptions for intermediaries conducting equity transactions on behalf of clients.

   (d) Enact legislation to allow private equity funds to enjoy the same tax exemption as offshore funds.

7. Innovation and technology sector

   (a) Allow the deduction of costs relating to research and development (R&D) activities outsourced to external parties, and to intellectual property provided to third parties to produce goods outside Hong Kong.

   (b) Grant “super deductions” of 150% for expenditure on R&D conducted in Hong Kong.

   (c) Offer unilateral tax credits for withholding tax on royalties where no double taxation agreement exists.

8. Regional operations for trading, headquarters and treasury

   (a) Allow approved treasury companies to qualify for deductions of interest paid to associates.

9. Salaries tax measures

   (a) Extend the scope of use of the deduction for self-education expenses to allow it to be used by the taxpayer's spouse or children aged 18 to 25, who are not in full-time education and who are not taxpayers, or not able to claim the deduction in their own right as taxpayers.

   (b) Review the personal allowances and allowances for dependants with view to identifying a benchmark for future, more regular adjustments. Make the basis for calculating future adjustments more transparent.

(c) Consider increasing child allowances for the second and third children to support the policy of encouraging child birth in Hong Kong.

(d) Allow deductions for individual taxpayers' voluntary contributions to their mandatory provident fund schemes, subject to an annual cap of HK$60,000 (i.e., additional to their mandatory contributions).

(e) Allow a deduction for private healthcare insurance premiums, subject to an annual cap of HK$12,000 per taxpayer and consider allowing additional deduction for taxpayer's who pay premiums to cover dependent spouses and children, subject to an annual cap of HK$12,000 per dependant.

(f) Widen the marginal tax bands to HK$50,000.

10. Housing

(a) Allow deduction of rental payment for the taxpayer's primary residence, as an alternative to the home loan interest deduction, subject to the annual cap of HK$100,000, for employees who are not claiming a housing allowance from their employers.

(b) Regularly review the effectiveness of additional stamp duty measures and make the review process transparent.

11. Property and utility concessions

(a) Waive rates for 2014-15 with a ceiling of HK$2,500 per quarter for each rateable tenement, limited, if administratively practicable, to self-use properties.

(b) Grant an electricity charge subsidy for 2014-15 of HK$1,800 to each residential electricity account. To encourage energy conservation, consideration should be given to restricting this concession to households whose energy consumption levels do not exceed a certain threshold.

12. Environment and conservation measures

(a) Offer accelerated building allowances for commercial and industrial complexes adopting environmentally-sustainable designs.

(b) Explore refund systems to encourage recycling and a wider adoption of the polluter pays principle.

(c) Set up a heritage body in Hong Kong to which cash donations should be deductible and explore further options for private/ public sector partnerships to better preserve heritage buildings and sites.

(d) Allow tax deductions based on cost plus 20% for surplus food stocks donated to charities engaged in distributing good quality surplus food to needy people.

# Facing Hong Kong's challenges
# Detailed proposals

Economies and markets are integrating very rapidly and business models are transforming. Previously, business operations that were country-specific have shifted to becoming regional or global supply chains. The growing digital economy has also allowed businesses to operate distant from the physical location of their customers. These developments have created opportunities to minimise tax burdens, through sophisticated tax planning, where cross-border activities may go untaxed anywhere, or be subject only to disproportionately low levels of taxation. The Organisation for Economic Co-operation and Development (OECD) is looking to address this issue via its initiative on base erosion and profit shifting (BEPS). The OECD is rolling out an action plan with a majority of the actions being targeted for completion within two years.[1]

Challenges are not limited to the global initiative on BEPS, but also stem from regional developments such as the opening up of the Shanghai free trade zone and Qianhai. Hong Kong should prepare for the potential changes and thoroughly consider how its tax policies can be made to attract and facilitate business growth, in addition to introducing more immediate budget measures to help businesses and the community.

## Tax policy

A predictable and competitive tax regime sets the tone to attract investment. To support Hong Kong's economic development, the Institute recommends the following measures:

1. Tax policy group

   Tax policies can be used to help drive and address Hong Kong's economic, social and long-term interests. The imposition by the Hong Kong SAR Government (government) of stamp duty measures, as a means of curbing excessive property speculation represents one example. Given the importance of the tax regime to the overall well-being of the economy and the community, the Institute reiterates its recommendation that the government should establish a tax policy group, with representatives from the Financial Services and the Treasury Bureau (FSTB) and investment promotion agencies, as well as, outside experts and academics. The group should:

   (a) Conduct ongoing strategic research into Hong Kong's tax competitiveness, and propose refinements to the tax system, taking into account the long-standing proposals advocated by the business sector and tax professionals (see proposals 4(a) to (f)). It may also need to consider options for broadening/ stabilising the tax base given that, for example, revenue from land sales may fluctuate and become more unpredictable as the government implements its commitment to increase the supply and sale of land. This is because land sales conducted on a regular basis would mean that, in principle, sales would take place whether the market was high or low.

[1] OECD (2013), Action Plan on Base Erosion and Profit Shifting, OECD Publishing.
http://dx.doi.org/10.1787/9789264202719-en

(b) In addition to the local dimension, the tax policy group could also monitor international developments in tax administration and advise the government on responding to such developments to ensure that Hong Kong can be proactive rather than reactive and so be better able to explain and safeguard its position internationally. This is important because, in the light of the BEPS action plan, it is likely that the international tax landscape will be undergoing major changes over the coming few years.

The OECD is expected to issue recommendations that will have repercussions on domestic rules, transfer pricing, tax treaties and information exchange[2] and the impact is likely to be felt outside of the OECD member states. China has already indicated its support for the action plan and Hong Kong needs to be prepared for the repercussions, in a holistic manner.

Hong Kong should develop a position on BEPS. It needs to consider the implications, including how this initiative could affect its territorial tax system. In this way, Hong Kong would be less likely to find itself having to defend its low-rate, source-based, tax system at a later date. Where appropriate, Hong Kong should take the opportunity to voice concerns.

We note that the government has indicated that Hong Kong has been closely following the BEPS developments and "will embark on studies and engage local stakeholders for appropriate follow-up actions in due course".[3] While we welcome this statement, we believe this matter should be given a high priority.

2. Transfer pricing

Transfer pricing is considered by the OECD to be a major dimension in the BEPS initiative. OECD is looking to introduce rules that would ensure transfer pricing outcomes are in line with value creation under current economic and commercial conditions. It would also be developing TP documentation rules, including a common template requiring corporations to provide information on their global allocation of income, economic activity and taxes paid to relevant governments.[4]

With significant impending changes, the Institute suggests that it is timely for Hong Kong to strengthen its transfer pricing regime by enacting a legislative framework, supported by additional interpretative guidance. For example, the interface with the Inland Revenue Ordinance (IRO) needs to be reviewed as the IRO does not give the Commissioner of Inland Revenue (CIR) clear authority for making transfer pricing adjustments outside of comprehensive avoidance of double taxation agreements (CDTAs), the interface between the "source" principle and transfer pricing rules needs to be made clear, and the documentation requirements need to be defined.

3. CDTAs/ exchange of information

The Institute supports the government's efforts to expand Hong Kong's network of CDTAs.

[2] OECD (2013), Action Plan on Base Erosion and Profit Shifting, OECD Publishing. http://dx.doi.org/10.1787/9789264202719-en
[3] LCQ13: Prevention of tax base erosion and profit shifting, 20 Nov 2013. http://www.info.gov.hk/gia/general/201311/20/P201311200394.htm
[4] OECD (2013), Action Plan on Base Erosion and Profit Shifting, OECD Publishing. http://dx.doi.org/10.1787/9789264202719-en

However, it seems that, on occasions, the expected treaty benefits have not always been enjoyed by Hong Kong taxpayers due to implementation issues relating to, for example, the determination of permanent establishments, residency and profit attribution.

Apart from implementation issues, OECD, via its BEPS action plan, will be looking to change the model tax convention to address issues arising from hybrid instruments and entities, treaty abuse and dispute resolution obstacles under the mutual agreement procedure. To give effect to various BEPS recommendations, it will be considering the use of a multilateral instrument to effect the changes required in bilateral tax treaties. It will also be enhancing transparency, including models of information sharing for international tax schemes between tax administrations.[5]

Against this background, the Institute proposes that the government give appropriate attention and allocate sufficient resources to resolving implementation issues, as well as, assessing and preparing for the impact of international developments on Hong Kong's treaty network and taxpayers.

4. Refinements to the tax system

The Institute believes that there is need to refine the tax system, by making it more certain and more competitive. Improvements also need to be made to the operations of the board of review. The following are examples of areas that need attention:

(a) Source of profits

Currently, there is a significant degree of uncertainty in the practical application of the fundamental principle of "source" in relation to the location of profits, which hinders businesses from being able to plan their tax affairs with a reasonable degree of certainty.

In view of this, we suggest the following measures to create a more predictable tax regime:

(i) Produce regular updates of departmental interpretation and practice notes (DIPN), inviting input from practitioners.

(ii) Encourage fuller use of the advance ruling system. The Inland Revenue Department (IRD) should be prepared to give and to publish advance rulings, wherever possible.

(iii) Codify some of the basic tests for determining the source of profits. This could be achieved by the introduction of appropriate amendments to the Inland Revenue Rules. For example, in the Hang Seng Bank case, Lord Bridge set out guidelines for the determination of the source of various types of profits.

[5] OECD (2013), Action Plan on Base Erosion and Profit Shifting, OECD Publishing. http://dx.doi.org/10.1787/9789264202719-en

(b) Taxation of unrealised gains

Following the recent decision of the Court of Final Appeal in Nice Cheer Investment Ltd. vs. Commissioner of Inland Revenue (CIR), the tax treatment of unrealised gains was made clearer. However, the courts judgment differs from the approach adopted by the IRD since the case of CIR v. Secan Ltd & Ranon Ltd, 5 HKTC 266, as reflected in the IRD's DIPN 42.

It is important that the IRD's approach going forward be clarified and that DIPN 42 be reviewed and revised, as appropriate, as soon as possible. We have highlighted the continuing uncertainty around the question of the taxation of unrealised gains for a number of years, since the Secan Ltd & Ranon case. It is now time to make the position clear once and for all.

(c) Distinction between revenue and capital

The distinction between revenue and capital for shareholdings could be made more certain as follows:

(i) For shares held for a minimum of three years, there should be a clear presumption that they represent a capital and not a trading asset, unless there is very strong evidence to the contrary.

(ii) For shares held for shorter periods, the treatment should be decided as it is now.

(d) Finalisation of tax affairs

The length of time for finalisation of tax affairs, particularly loss cases, poses uncertainty for businesses. In this regard, the following measures are proposed:

(i) The statutory time limit for reopening an assessment should be shortened from the current six years to three years, for cases not involving fraud. Cases involving fraud should retain a ten-year limitation period. Shortening the time-bar period would mean taxpayers could promptly finalise their tax affairs, reducing the time and effort for queries relating to historical data. Numerous jurisdictions, including Australia, United States and Singapore adopt a shorter time bar period than Hong Kong.

(ii) Statements of loss should be issued within a definite period of time, and accorded the same status as notices of assessment. Taxpayers are now unclear as to whether losses are available for setting off against future profits. When statements of loss are not treated as assessments, it means that the clock on the six-year limitation period does not start when such statements are issued. Consequently, the taxpayers' affairs can be kept open for well beyond six years and records may also need to be retained, at times beyond the general statutory record-keeping requirement of seven years.

(e) Group loss relief

To make the tax system more competitive, the Institute has for some time proposed that a form of group loss relief be introduced in Hong Kong.

We note that the government considers that the measure may not benefit small and medium enterprises (SMEs), which constitute 98% of business establishments.[6] However, such relief would provide a simple, but much-needed, measure of relief to corporate groups. For legitimate commercial reasons, many businesses operate in the form of a group of companies, to diversify the risk of different types of activities or for operating in different locations and environments. Some companies within the group may record allowable losses, whilst others have taxable profits.

We also note the government's concern that the measure could be easily abused.[7] However, anti-avoidance provisions could be introduced, such as specifying an appropriate definition of a group (for example, the relevant companies having to be 90% owned by the same parent company) and stipulating that losses can only be transferred to offset current profits, without any carry back of losses to past years' profits of other companies within the group. The United Kingdom (UK), United States, Australia and Singapore, for example, successfully operate group loss relief systems.

(f) Loss carry-back

The Institute has also proposed the introduction of loss carry-back provisions to make the tax system more competitive. At present, if a company incurs an allowable tax loss in any year, that allowable tax loss can only be carried forward for setting off against subsequent profits of that company. We note that the government views that loss-carry forward should be able to assist enterprise to manage their losses.[8] However, the effectiveness of a loss-carry forward provision is limited to a company becoming profitable and viable again, after experiencing losses.

Without loss carry-back provisions, the effects of fluctuations in a company's results could be exacerbated, particularly during economic downturns, and could contribute to cash flow problems.

(g) Board of Review

We reiterate our recommendation that a full-time panel, comprising individuals with extensive tax expertise, be established to hear the more complex tax cases before the Board of Review (BOR). This would equip the BOR with a high level of tax knowledge and experience whilst addressing any concerns about conflicts of interest, as the panel members would be employed full time on the BOR. This was one of the Institute's suggestions, in response to a limited government consultation on the operation of BOR in 2008, following, amongst other things, comments by judges in the ING Baring case on the current BOR arrangements.

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[6] LCQ2: Enhancing Hong Kong enterprises' competitiveness, 16 Mar 2011. http://www.info.gov.hk/gia/general/201103/16/P201103160178.htm
[7] LCQ2: Enhancing Hong Kong enterprises' competitiveness, 16 Mar 2011. http://www.info.gov.hk/gia/general/201103/16/P201103160178.htm
[8] LCQ2: Enhancing Hong Kong enterprises' competitiveness, 16 Mar 2011. http://www.info.gov.hk/gia/general/201103/16/P201103160178.htm

Acknowledging the advantages of the existing simple, inexpensive and informal procedures, simple or non-complex cases could continue to be dealt with by part-time members of a general panel, which should include deputy chairmen. However, we suggest that the general panel should be smaller than the present pool of members to ensure that the general panel develops more expertise in taxation matters.

When members of the proposed specialist panel are not engaged in hearing complex cases, they could sit as the chairman of BORs to hear non-complex cases, which would ensure cohesion in the administration of this part of the tax system, and that the precedents of previous BOR decisions would be more likely to be followed or distinguished.

## Budget measures

While there are periodic signs of improvement, the global economy is still affected by the lingering aftermath of the financial crisis and by the sovereign debt crisis in Europe. In October, the International Monetary Fund revised downward its projection for global growth for 2013 to 2.9% from 3.2%, saying that global growth is still weak and the risks remain to the downside. Although, Hong Kong's economic growth slowed to 2.9% in the third quarter compared with 3.2% in the second quarter, the government expects to achieve GDP growth of 3% for the year, which is at the upper end of the range forecast in the 2013-14 budget. Inflation in Hong Kong is expected to be around 4.3% for the year, while the unemployment rate remained low at 3.3% in the third quarter. Hong Kong has returned to being one of the top destinations for initial public offerings in 2013. However, with the establishment for the first time of an official poverty line in Hong Kong, published in September, it emerged that 1.31 million people (19.6% of the population) in Hong Kong are living below the official poverty line, albeit this figure drops to 1.01 million (15.2%) if welfare payments are taken into account.

The Mainland's third quarter growth of 7.8% means that the country look set to at least meet the Mainland government's target of 7.5% for the year, albeit that this will be the slowest growth for two decades.

Against the above background, Institute recommends the budget measures below to help strengthen the economy and support the community:

5. <u>Profits tax measures</u>

   The Institute considers that the general profits tax rate should remain at 16.5%. However, the Institute proposes other measures for business in Hong Kong:

   (a) To assist the SME sector, the corporate profits tax rate should be lowered to 15% for companies whose gross income does not exceed HK$5 million.

   (b) The business registration fee should be waived for 2014-15.

6. <u>Asset management and financial services centre</u>

   We note that from the recently-published research papers from the Financial Services Development Council that the council is proposing various tax measures to incentivise the development of the asset management industry, including private equity funds and real estate investment trusts. We agree that asset management is an important part of the financial services sector and we propose the following measures:

(a) For Hong Kong-resident funds, an exemption should be granted, similar to that currently enjoyed by offshore funds. This provides a more level playing field for onshore and offshore funds. Singapore, for example, offers concessions to Singapore-domiciled funds, the salient features of which are indicated at Appendix 1.

(b) For life insurers, the existing charging section of the IRO (i.e. section 23), should be reviewed, as the current provision is no longer in line with developments in the industry. For example, income relating to the investment portion of unit link products should not be included as insurance premiums for computing the 5% deemed assessable profits.

(c) Measures relating to stamp duty should also be considered, such as, providing an exemption from stamp duty for intermediaries conducting equity transactions on behalf of clients (as in the UK, for example).

(d) The Institute welcomed the proposal in last year's budget to allow private equity funds to enjoy the same tax exemption as offshore funds. We recommend that the government roll out the consultation and work towards enacting the relevant legislation as early as possible.

7. <u>Innovation and technology sector</u>

To encourage the development of the innovation and technology sector, the Institute proposes the following measures, with appropriate anti-avoidance measures:

(a) Allow the deduction of costs relating to research and development (R&D) activities outsourced to external parties and to intellectual property (IP) provided to third parties to produce goods outside Hong Kong.

For example, it is common for businesses to develop IP in house; engage with other associated companies in cost-sharing arrangements for IP; provide/ license IP to third parties, such as contractors, to produce goods outside Hong Kong, and outsource R&D activities to external parties, which are quite likely to be outside of the limited list of approved research institutes[9]. Section 16B restricts deductions to R&D payments made to approved research institutes or to R&D conducted in house by the taxpayer. Meanwhile section 16EC(4)(b) denies taxpayers a deduction where a person hold rights as a licensee of the IP rights, and the IP rights are used wholly or principally outside of Hong Kong by a person other than the taxpayer.

A distinction should be drawn between the entities that assume the risks and benefits of an R&D investment (R&D investor), and the entities that are simply paid to provide R&D work or services (R&D services provider). The R&D investor is the entity that makes the investment, directs the project, undertakes the risk on the investment and, ultimately, owns the resulting IP, whereas the R&D service provider does not undertake any risk, acts according to the direction of the R&D investor and may perform only a certain

[9] A list of Approved Institutes under Section 16B and 16C of the Inland Revenue Ordinance is available at http://www.ird.gov.hk/eng/tax/bus_16bc.htm

element of the R&D project. The services provider may be offshore because the required skills and cost structure may favour those activities being undertaken in that offshore location. However, R&D investors should not be disadvantaged for making that commercial decision and it is not in the interests of the development of Hong Kong's economy that they should be. This distinction is recognised and accommodated in the tax systems of a number of other jurisdictions.

So, subject to a suitable definition of what constitutes R&D, where R&D is conducted offshore, a 100% deduction should be allowed with a more liberal regime than now exists.

(b) The Institute recommends that "super deductions" of 150% of the actual cost incurred be allowed, where the R&D is conducted in Hong Kong. Similar additional deductions are offered in Australia, Singapore, the Mainland and the UK, among other places.

(c) In respect of withholding taxes paid on royalties, where no CDTA exists, the Institute proposes that a unilateral tax credit be granted for all foreign tax paid on royalties that are subject to tax in Hong Kong.

8. <u>Regional operations for trading, headquarters and treasury</u>

To strengthen Hong Kong's position as a hub for regional operations, the Institute proposes the following measures:

(a) The interest rate deduction rules should be reviewed to encourage international companies to use Hong Kong as their "cash pooling hub". With its well-established financial system, Hong Kong is equipped to be a regional centre, handling the financial management of overseas associates within a group of companies. However, as financial margins are usually thin, tax measures can provide a further incentive for international businesses to establish their treasury function in Hong Kong. Currently section 15(1)(f) of the IRO, deems the interest derived from Hong Kong by a corporation carrying on a trade or business in Hong Kong to be subject to profits tax at the standard corporate rate.

Specifically for group treasury operations, if their interest income is taxable they should be able to deduct interest that they pay on monies received from overseas associated companies. While, in principle, they may be able to claim a deduction under section 16(2)(c) of the IRO, this may not always be clear cut, in the context of case law and IRD practice. In order to encourage this area of business in Hong Kong, we propose that "approved" treasury companies should qualify directly for deductions of interest paid to associates, without having to rely on section 16(2)(c).

9. <u>Salaries tax measures</u>

To assist taxpayers with the increasing cost of living, provide more support for families and to facilitate members of the community to gain the necessary skill sets to succeed in a knowledge-based society, the Institute recommends the following measures:

(a) To encourage people to invest in their education and training and to upgrade their skills in order to increase employment opportunities, the Institute recommends extending the scope of application of the deduction for self-education expenses so that they may also be used by the taxpayer's dependants. The deduction limit of HK$80,000, if not claimed, or not fully claimed, by the taxpayer, should be permitted to be applied for self-education expenses by the taxpayer's spouse for training to join or re-join the workforce, or by the taxpayer's children between 18 to 25 years old, who are not in full-time education and who are not taxpayers, or not able to claim the deduction in their own right as taxpayers.

(b) The Institute recommends that a review be conducted to identify a benchmark for adjusting allowances on a regular basis, based on, for example, general inflation and other factors. This should include the personal allowances for single and married persons, allowances for children, dependent siblings, dependent parents or grandparents, single parents and disabled dependants. The Institute notes that, in recent years, increases in the allowances for other dependants have not always kept pace with those for children and the rationale for these differential increases has not been made clear. For example, child allowances have increased by 40% since 2008-09, while allowances for most other dependants have increased by only 26.6% and for dependent siblings and disabled dependants by only 10%. The basis and rationale for future adjustments in each case should be made more transparent.

(c) In view of the ageing population and the low fertility rate of about 1.3[10], the Institute recommends the government to consider increasing the child allowance for the second and third children.

(d) To encourage people to save more for their retirement, over a longer period, we recommend additional deductions be provided for voluntary contributions by taxpayers to their mandatory provident funds, of up to HK$60,000 annually. These contributions should become taxable if withdrawn before retirement.

(e) With the view to encouraging more efficient utilisation of both public and private healthcare services, we propose that taxpayers be allowed a deduction for the cost of private healthcare insurance premiums, subject to an annual cap of HK$12,000 per taxpayer. In addition, the government should consider allowing taxpayers to claim deductions for premiums paid on behalf of dependent spouses and children, subject to the same annual cap of HK$12,000 per dependant.

(f) To assist the middle and lower income taxpayers, we propose changes to the progressive rates, specifically that the marginal tax bands be widened from HK$40,000 to HK$50,000.

The proposed measures for salaries tax are contained in Appendix 2, while the impact of the changes for a typical individual and family are in Appendices 3 and 4, respectively.

10. <u>Housing</u>

To help support the community's housing needs, the Institute proposes the following measures in relation to home ownership and accommodation.

(a) The home loan interest deduction should be allowed to be used in relation to rental payments in respect of a taxpayer's primary residence, subject to an annual limit of

[10] Census and Statistics Department, Population Estimate, Table 004 : Vital Events. http://www.censtatd.gov.hk/hkstat/sub/sp150.jsp?tableID=004&ID=0&productType=8

HK$100,000. Employees who are already claiming a housing allowance from their employers should not be eligible for this benefit.

(b) The Institute accepts that the additional stamp duty measures, such as buyer's stamp duty and special stamp duty, are justifiable measures in order to curb excessive speculation in the market, which has been a contributing factor in private housing becoming unaffordable for many Hong Kong people. However, an overly broad-brush approach may have negative repercussions on some normal "non-speculative" property activities conducted by individuals and businesses. Therefore, these additional stamp duty measures should be temporary. The long-term, strategic solution must be to increase land supply to meet Hong Kong's housing needs. The Institute proposes that the government regularly review the effectiveness of these measures and ensure that the review process is transparent, with the provision of relevant supporting information, such as property market statistics and plans to increase land supply.

Once it has been decided to remove the additional stamp duty measures imposed to cool the property market, the price thresholds at which different levels of stamp duty apply on the sale or transfer of immovable property, should be adjusted in line with property price inflation. Periodic reviews will be needed to monitor whether the stamp duty thresholds are reflective of property price inflation at any given time.

11. Property and utility concessions

The Institute also recommends the following concessions continue to be provided:

(a) Rates waiver for 2014-15, subject to a ceiling of HK$2,500 per quarter. If administratively practicable, this measure should apply to self-use properties only.

(b) For further immediate support to the community, particularly in the light of the impending electricity price rises, the electricity charge subsidy of HK$1,800 should again be granted to each residential electricity account for 2014-15. However, to promote energy conservation, consideration should be given to limiting this subsidy to households to those whose energy consumption does not exceed a certain threshold (per capita).

12. Environment and conservation measures

With a view to ensuring that economic development remains sustainable and goes hand in had with community development, the Institute proposes the following measures:

(a) Provide accelerated industrial building and commercial building allowances for new commercial and industrial complexes adopting approved, environmentally-sustainable designs, given that the existing allowances are for installations and equipment only.

(b) Explore refund systems to encourage recycling and a wider adoption of the polluter pays principle, including charging for household waste.

(c) Set up a heritage body in Hong Kong to which cash donations should be deductible as they are to charities (akin to, for example, the National Trust and English Heritage in the UK). For better preservation of heritage buildings and sites, further options for private/ public sector partnerships could be explored.

(d) There are charities in Hong Kong performing a valuable community service by collecting surplus, good quality food from shops, restaurants etc. and redistributing it to the needy. This not only provides help and support to those in the greatest need, which, as the poverty line shows, is potentially a significant number of people, but it also reduces the quantity of usable food being disposed of unnecessarily in landfills. This laudable work needs policy support from the government, just as similar work receives in many jurisdictions overseas.

One element of this support can be the provision of tax incentives for companies to donate surplus stocks of good-quality food to charities that are geared up to redistribute this food to target groups. We propose that the government consider allowing deductions to be claimable for food donations of this kind. There is a variety of arrangements in place in other jurisdictions (see Appendix 5). As there are currently no general landfill or waste disposal charges in Hong Kong to serve as a disincentive to disposing of unused food, the Institute suggests that, in order to incentivise such donations, deductions be based on the original cost of the food plus, say, 20%.

Hong Kong Institute of CPAs
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## Features of exemptions for Singapore-domiciled funds

A) Main requirements for Singapore domiciled fund exemption

Criteria for exemption:

- Singapore-incorporated and Singapore tax resident company, managed by prescribed Singapore fund manager and using a Singapore-based fund administrator.
- The fund must have at least one foreign investor.
- It must incur at least S$200,000 expenses in each financial year/ period.
- Prior approval from the Monetary Authority of Singapore (MAS) is required and an income tax return and an annual declaration need to be lodged annually.
- Anti-tax avoidance measures apply in respect of transfer of assets.

Scope of exemption:
*Fund*

- “Specified income” from “designated investments”, which, amongst others, excludes shares of private companies that are mainly in the business of trading or holding of Singapore immovable properties (other than the business of property development).

*Investors*

- "30/50 threshold rule" is applied to non-individual investors that generally have a presence in Singapore and if this is not met, such investors are considered non-qualifying investors.
- Non-qualifying investors, which broadly covers Singapore corporate entities that beneficially own, alone or with their associates, more than 30% (or 50% if the fund has 10 or more investors) of the total value of the issued securities of the qualifying fund will suffer a financial penalty, computed on the current Singapore corporate tax rate on their respective share of the fund’s current year profit.

B) Singapore enhanced-tier fund tax incentive

Criteria for exemption:

- Fund can be a company, limited partnership or trust (with certain exclusions) with a minimum fund size of S$50 million at the point of application. In addition, if it is a company incorporated in Singapore, it needs to use a Singapore-based and resident fund administrator.
- It must be managed or advised directly by a qualifying fund management company, which employs at least three investment professionals. The fund must incur at least S$200,000 local expenses in each financial year.
- Prior approval from the MAS is required and an income tax return and an annual declaration need to be lodged annually regardless of where the fund is constituted/ located.

Scope of exemption:
*Fund*

- As for Singapore-domiciled fund incentive.

*Investors*

- No "30/50 threshold rule”.

## Proposed changes for salaries tax allowances, deductions, and rates

| Allowances, deductions and rates | Existing (HK$) | Proposed (HK$) |
|---|---|---|
| Allowances: | | |
| • Basic | 120,000 | 126,000[11] |
| • Married person | 240,000 | 252,000[11] |
| • Child – annual (for each dependant) | 70,000 | 73,500[11] |
| • Child – initial (for each dependant) | 70,000 | 73,500[11] |
| • Dependent brother or sister (for each dependant) | 33,000 | 44,100[12] |
| • Dependent parent/ grandparent (for each dependant) | | |
| - aged 60 or above or is eligible to claim an allowance under the government's disability allowance scheme | 38,000 | 44,100[12] |
| - aged 55 or above but below 60 | 19,000 | 22,050[12] |
| • Additional dependent parent/ grandparent (for each dependant) | | |
| - aged 60 or above or is eligible to claim an allowance under the government's disability allowance scheme | 38,000 | 44,100[12] |
| - aged 55 or above but below 60 | 19,000 | 22,050[12] |
| • Single parent | 120,000 | 126,000[11] |
| • Disabled dependant (for each dependant) | 66,000 | 88,200[12] |
| Deductions, maximum limit: | | |
| • Self-education expenses | 80,000 limited to claims by taxpayer | 80,000 extended to claims by taxpayer, spouse, or children between 18 to 25 studying part-time |
| • Voluntary MPF contributions | - | 60,000 |
| • Private healthcare insurance premiums | | |
| - taxpayer | - | 12,000 |
| - additional dependent spouse/ children (for each dependant) | - | 12,000 |
| • Rental payment for taxpayer's primary residence | - | 100,000 |
| Progressive rates – marginal tax bands | 40,000 | 50,000 |

[11] Proposed allowances are increased under the assumption that the benchmark is set at current levels and an inflation rate of 5%.
[12] Proposed allowances are increased in line with the percentage increases in child allowances since 2008-09 and under the assumption of an inflation rate of 5%.

## Example of impact of proposed changes in salaries tax allowances and deductions on a typical individual

Example: Single person

This example illustrates the impact of:[13]

- an increase of basic allowance to HK$126,000,
- a deduction for voluntary MPF contributions with annual limit of HK$60,000,
- a deduction for private healthcare insurance premiums with annual limit of HK$12,000,
- widening the marginal tax band to HK$50,000, and
- a deduction of rental payment with annual limit of HK$100,000.

| | Existing (HK$) | | Proposed (HK$) | | Dollar savings (HK$) | Per-centage savings |
|---|---|---|---|---|---|---|
| | 2013-14 | | 2014-15 | | | |
| Income | | 300,000 | | 300,000 | | |
| Allowance/ <u>deduction:</u> Basic allowance | 120,000 | | 126,000 | | | |
| Mandatory MPF contribution | 15,000 | | 15,000 | | | |
| Voluntary MPF contribution[14] | - | | 15,000 | | | |
| Private healthcare insurance | - | | 12,000 | | | |
| Rental payment | - | | 100,000 | | | |
| Total allowance | | 135,000 | | 268,000 | | |
| Net chargeable income | | 165,000 | | 32,000 | 133,000 | |
| Tax payable | | 16,050 | | 640 | 15,410 | 96% |

[13] Assumptions, as for Appendix 2.
[14] Assume annual voluntary MPF contribution of HK$15,000 (or monthly voluntary MPF contribution of HK$1,250).

**Appendix 4**

## Example of impact of proposed changes in salaries tax allowances and deductions on a typical family

Example: Married person with spouse separately assessed, two children who are not newborns, and living with two dependent parents over 60 years of age throughout the whole year

This example illustrates the impact of:[15]

- an increase of basic allowance to HK$126,000,
- an increase in child allowance to HK$73,500,
- an increase of dependant parents allowance and additional allowance to HK$44,100,
- a deduction for voluntary MPF contributions with annual limit of HK$60,000,
- a deduction for private healthcare insurance premiums with annual limit of HK$12,000, and
- widening the marginal tax band to HK$50,000.

| | Existing (HK$) | | | | Proposed (HK$) | | | | Dollar savings (HK$) | Per-centage savings |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2013-14 | | | | 2014-15 | | | | | |
| Income | | | | 600,000 | | | | 600,000 | | |
| Allowance/ deduction: Basic allowance | | | 120,000 | | | | 126,000 | | | |
| Child allowance | 70,000 per child | 2 children | 140,000 | | 73,500 per child | 2 children | 147,000 | | | |
| Dependent parent allowance | 76,000 per parent | 2 parents | 152,000 | | 88,200 per parent | 2 parents | 176,400 | | | |
| Mandatory MPF contribution | | | 15,000 | | | | 15,000 | | | |
| Voluntary MPF contribution | | | - | | | | 60,000 | | | |
| Private healthcare insurance | | | - | | 12,000 | 1 taxpayer and 2 children | 36,000 | | | |
| Total allowance | | | | 427,000 | | | | 560,400 | | |
| Net chargeable income | | | | 173,000 | | | | 39,600 | 133,400 | |
| Tax payable | | | | 17,410 | | | | 792 | 16,618 | 95% |

[15] Assumptions, as for Appendix 2.

The Global FoodBanking Network

# Product Liability Protection and Tax Deductions

| Country | Food Bank | Product Liability Protection | Tax Deductions | VAT Situation |
|---|---|---|---|---|
| **Argentina** | Red Argentina de Bancos de Alimentos | No | Yes to both. For products, the cost of merchandise is available as a tax credit up to 5% of the taxable amount of that good. | No, but if any credit was issued to the donor that credit must be returned to the Ministry of Finance. |
| **Australia** | Foodbank Australia | Yes (no national law but every state has their separate legislation) | Available for both financial and product donations | No VAT paid by donors or the Food Bank. |
| **Canada** | Food Banks Canada | Yes (no national law, but many provincial and territorial laws, often referred to as "Donation of Food Act") | Yes on financial donations.<br>For product donations, they are considered gifts in kind, that if valued by an objective 3rd party can be eligible for certain tax measures. | Depends:<br>½ of Canada has a VAT, the other ½ does not (simple sales tax instead).<br>From that, manufacturers do not pay a VAT on donated goods, but retailers do. |
| **Chile** | Red de Alimentos | No | Yes for both product donations and financial donations | The IRS continues to recognize any VAT credit associated with the purchase of the materials related to those donations. |
| **Colombia** | ABACO | No | Yes for both financial donations and product donations ( the value of the donation up to 30% of the taxpayers net income) | Yes when the donating entity would otherwise remain responsible for the sales tax and retail quality |
| **Ecuador** | Banco de Alimentos Diakonia | No | Yes for product donations (no for financial donations). Companies have the ability to sell your product to the food bank at a "symbolic" and the resulting loss can be accounted for in financial statements. | No VAT paid by donors or the Food Bank |
| **Egypt** | Egyptian Food Bank | No | Yes for both financial and product donations but are capped at 10% of the donors taxable base. | No VAT paid by donors or the Food Bank |

The Global FoodBanking Network

# Product Liability Protection and Tax Deductions

| Country | Food Bank | Product Liability Protection | Tax Deductions | VAT Situation |
|---|---|---|---|---|
| **Guatemala** | Banco de Alimentos de Guatemala | No | No for financial donations. Yes for product donations. | Yes, 12% the cost of the good. |
| **Israel** | Leket Israel | No | Yes for both financial and product donations. | Yes VAT must still be paid |
| **Japan** | Second Harvest Japan | No | No | No |
| **Mexico** | Asociación Mexicana de Bancos de Alimentos | Yes, Limited liability protection for donors under the General Health Law | Financial: Yes limited to 7% of the profits generated the year of donation<br>Product: Yes maximum rate varies on profit margin. | No |
| **Paraguay** | Fundación Banco de Alimentos de Paraguay | No | Yes to both, up to 1% of tax. | No, donors are exempted from paying VAT. |
| **South Africa** | FoodBank South Africa | No | Yes to both. Product (in-kind) donations are limited to 10% of taxable income. | No |
| **Turkey** | Gıda Bankacılığı Derneği | No | Yes to both, but depends on the exact classification of the individual food bank. | No |
| **United Kingdom** | FareShare UK | No (a bill is currently being debated on the floor of the House of Commons) | Yes to both, individuals who donate financially and are UK citizens can GiftAid their donation (20% of the donation is matched by customs and revenue).<br>Products can claim in-kind donation of trading stock, equipment or employee secondment. | Yes (specifics are currently being gathered) |
| **United States of America** | Feeding America | Yes | Yes to both | No VAT in USA. |