Tax policy and budget proposals

2015 - 16

Planning for Hong Kong's Future

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

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The Institute's 2015-16 budget proposals, under the heading "Planning for Hong Kong's future" developed by the executive committee of the Taxation Faculty, focus on tax policies and measures on the revenue side of the budget. Outlined below are the main measures proposed.

Tax policy

1. With the objective of strengthening and safeguarding Hong Kong's long-term position as a leading financial and commercial centre, establish a standing tax policy unit to conduct ongoing strategic and comparative research into Hong Kong’s tax competitiveness, monitor international developments in tax administration and make appropriate recommendations. Among the subjects that it should consider are:

   (a) Improving the certainty and enhancing the competitiveness of the tax system

   (b) Reviewing the effectiveness of different tax incentives

   (c) Considering the need for more formal transfer pricing rules

   (d) Monitoring the implementation of comprehensive double tax agreements and the implications of developments in international taxation such as exchange of tax information

   (e) Maintaining long-term fiscal stability

2. Allocate sufficient resources to the development of tax policy and administration to ensure that critical tax issues can be followed up quickly and agreed tax measures can be implemented within reasonable timeframes.

Budget measures

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

   (a) For companies whose gross income does not exceed HK$5million, reduce the corporate profits tax rate to 15%, as a support for the small and medium enterprises sector.

   (b) Waive the business registration fee for 2015-16.

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

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

   (b) Review the current tax position in relation to the new (Additional Tier 1) capital requirements for banks under Basel III, and consider allowing deductions for distributions on the relevant instruments.

5. Innovation and technology sector

   (a) Allow the deduction of costs relating to research and development 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 research and development conducted in Hong Kong.

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

6. Salaries tax measures

   (a) Consider widening the marginal tax bands from HK$40,000 to HK$50,000, to assist lower and middle income earners, in the face of the rising cost of living.

   (b) Allow deductions for individual taxpayers' additional, voluntary contributions to their mandatory provident fund schemes, subject to an annual cap of HK$60,000, to help people to plan better for their retirement.

   (c) To support people's efforts to upgrade their skill sets, extend the scope of use of the deduction for self-education expenses, by allowing any portions not used by the taxpayer to be used by the taxpayer's spouse or by the taxpayer's children aged 18 to 25, who are not in full-time education or not able to claim the deduction in their own right as taxpayers.

   (d) Allow a deduction for private healthcare insurance premiums, subject to an annual cap of HK$12,000 per taxpayer for the coming year and consider allowing additional deduction for taxpayer's who pay premiums to cover dependent spouses and children, subject to a similar annual cap per dependant. This aims to reduce the burden on the public health care system and give people greater choice.

   (e) Review and rationalise the level of existing salaries tax allowances, including allowances for dependants. Pending the review, the allowances should be increased broadly in line with inflation.

7. Housing and utility measures

   (a) Allow deduction of rental payment for the taxpayer's primary residence, as an alternative to the home loan interest deduction, subject to the same annual cap of HK$100,000, (other than for employees who are already claiming a housing allowance from their employers). This aims to assist those who cannot afford to buy their own homes and who need to rent in the private rental market.

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

(c) Grant an electricity charge subsidy for 2015-16 of HK$1,800 to each residential electricity account. Consideration should be given to limiting it to those whose energy consumption levels per capita do not exceed a certain threshold, to promote energy conservation.

8. <u>Environment and social measures</u>

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

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

Tax policy and budget proposals 2015-16
"Planning for Hong Kong's Future"
Detailed proposals

Tax policy

Hong Kong's low-rate, simple tax system remains one of the important factors for its economic success. However, in an environment powered by change, today's success factors may not be sufficient to fuel tomorrow's success.

Strategically, charting policies to support Hong Kong's future development is crucial, as we face a variety of challenges. Among these challenges are increasing competition from other markets in the region, as they become more international in their outlook and more responsive to market forces and trends, and also pressure on Hong Kong's long term fiscal position.

Adopting a "wait-and-see" approach is not necessarily a prudent option because changes in strategy and fiscal policy take time to implement and the effects cannot be felt overnight. Hong Kong is an international financial market and a responsible member of the international community, but we need to be more proactive shaping our own tax policies and responding to developments and initiatives that have global implications, such as the Organisation for Economic Cooperation and Development ("OECD")'s base erosion and profit shifting ("BEPS") action plan. This requires resources.

It is also important that, once a tax policy has been agreed and announced, it should proceed expeditiously, or if it requires further study, that this take place and conclusions be arrived at as soon as possible thereafter. Again this depends on resources being made available and the development of the tax system and tax administration being given the priority that they merit in a modern economy, particularly one which places the tax system near the top of its list of advantages.

We believe that there is scope for more to be done to bolster Hong Kong's tax competitiveness and the efficiency of its system of administration. We also believe that this is an important policy area and we would urge the government to move it up the agenda.

1. <u>Tax policy unit</u>

   Given the importance of the tax regime to the overall well-being of the economy and the community, the Institute restates its recommendation for the establishment of a standing tax policy unit, with representatives from the Financial Services and the Treasury Bureau ("FSTB") and investment promotion agencies, as well as, outside experts and academics.

   The unit's role should include monitoring international developments in tax administration, conducting ongoing strategic research into Hong Kong’s tax competitiveness, and making recommendations on appropriate courses of action to ensure that Hong Kong can strengthen and safeguard its long-term position as an international and commercial centre. Issues that it would need to consider include:

(a) Transfer pricing

With significant changes expected under the BEPS initiative, 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 Inland Revenue Ordinance (Cap. 112)("IRO") does not clearly allow the Commissioner of Inland Revenue ("CIR") to make transfer pricing adjustments outside of comprehensive avoidance of double taxation agreements ("CDTAs"). There is also a need to clarify the interface between the "source" principle and transfer pricing rules and to define documentation requirements.

(b) CDTAs/ exchange of information

While the Institute welcomes the government's efforts to expand Hong Kong's treaty network and fulfil its responsibilities as a good global citizen in terms of tax transparency, the Institute proposes that the government should allocate the resources necessary to resolve implementation issues, as well as to assess the impact of international developments on Hong Kong's treaty network and taxpayers.

It seems that, on occasions, expected treaty benefits have not always been enjoyed by Hong Kong taxpayers due to implementation issues relating to, for example, the determination of concepts such as permanent establishment, residency and profit attribution. This may be further complicated with rapid developments in tax transparency, following BEPS.

The likely implications and impact for Hong Kong of international developments in relation to exchange of tax information ("EOI"), is another area where advance study and planning would be beneficial, so that Hong Kong taxpayers would be better prepared for changes and could provide timely input into the Hong Kong SAR Government's strategic position. The difficulty with the current situation is that Hong Kong can easily find itself on the back foot, having to adopt new measures and to defend its low tax regime. Furthermore, from a practical point of view, shortly after one significant change has been accommodated, preparations may need to be made for the next, given the pace of change internationally. This can result in uncertainty and a certain amount of frustration on the part of taxpayers and other stakeholders.

In the case of EOI, over the past two to three years Hong Kong has been under pressure to accept, firstly, an expanded scope of EOI upon request, under CDTAs, then standalone tax information exchange agreements, followed by arrangements within the financial services sector in Hong Kong for implementing the United States Foreign Accounts Tax Compliance Act, and, most recently, the adoption of the OECD's the common reporting standard to implement automatic EOI.

(c) Changes to the tax system

The Institute recommends that the government considers a number of long-standing proposals, advocated by the business sector and tax professionals, to improve the clarity and certainty, and enhance the competitiveness, of the tax system.

As regards clarity and certainty, proposals include clarifying the rules on source of profits and on the taxation of unrealised gains; distinguishing between the treatment of shares as revenue or capital; reducing the statutory time bar for finalisation of tax affairs; according a statement of loss the same status as a notice of assessment, and establishing a full-time panel with tax expertise to hear complex Inland Revenue Board of Review ("BOR") cases.

On the source of profit, there have been a number of court decisions in recent years that have challenged the Inland Revenue Department ("IRD")'s interpretation of the source rules, such as the *ING Barings* and *Li & Fung* cases. There has also been a recent decision, in the case of *Nice Cheer Investment Ltd. v CIR*, which questioned the IRD's position on the taxation of unrealised gains, based on, what now appears to have been, a mistaken view of the judgment in the 2001 case of *CIR v Secan Ltd. & Anor*. There is a perception that, on the one hand, a narrow interpretation is sometimes given to judgments in cases, which, prima facie, do not have a very peculiar set of facts, and, on the other hand, a broad interpretation may be given to decisions in cases where the facts appear to be less commonplace. While the need to protect Hong Kong's revenue base is fully appreciated, this seems to points to an over reliance on the uncertainties of case law interpretations and, as a corollary, the need to consider amending the legislation more extensively.

As regards the competitiveness of the tax system, proposals include introducing group loss relief and loss carry-back arrangements.

Further details are contained in Appendix 1.

(d) Review of tax incentives

As part of its consideration of Hong Kong's tax competitiveness, the tax policy unit should consider reviewing the usefulness and effectiveness of tax incentives. Each year, various organisations, including the Institute, propose different, specific measures to support the economy or sectors of the economy. However, post implementation, no reviews or studies are generally carried out on how useful they have been in generating more economic activity. The findings of such studies could provide valuable information to help rationalise existing incentives and to inform discussion on future possible incentives.

(e) Long-term fiscal stability

In view of the projected long-term demands on Hong Kong's tax system, options for broadening and stabilising the tax base must continue to be on the table. The ageing of the population and the associated pressures on the tax system (e.g., rising health care costs), and the increasing volatility and unpredictability of key sources of revenue, including land premiums (as the government implements its commitment to increase the land supply), all mean that the existing system is likely to come under increasing strain. While proposals for a goods and services tax have received only limited support in the past, this is not the only option and other means of broadening the tax base should also be studied.

2. Resources

We do not underestimate the difficulties involved in dealing with some of the above issues and our purpose is not to finger point. We also appreciate that tax must compete for resources with other government policy areas and that reasonable constraints on the growth of public expenditure should be maintained. However, a more competitive tax system and efficient administration should, in the final analysis, help to increase overall revenues. Furthermore, although, at its root, the tax system may still be relatively simple, it is clear that, given Hong Kong's standing in a global economy, and the need to respond to increasing pressures from the international regulatory community, and, given also, the ongoing impact of changing businesses practices, over the years, tax administration has become much more complex. The resources allocated to this area need to reflect these changes.

As indicated above, there are a number of initiatives that have been started or been talked about, which should be taken forward as soon as possible. We believe that, once again, resources are a factor in how expeditiously these can progress. They include:

(a) Fund management: The extension of the offshore fund exemption for private equity funds and the implications of the open-ended fund company structure. We note that legislation is now being developed to implement the changes in relation to offshore funds announced in the 2013 budget speech. While this is a positive development, in the Institute's view, more may need to be done and more quickly to strengthen Hong Kong's position as a global financial centre.

(b) The new Companies Ordinance (Cap. 622) commenced in March of this year. Amongst other things, it provides for a court-free amalgamation process. The tax treatment resulting from court-free amalgamations of companies needs to be clarified.

(c) Electronic filing of simple tax returns was introduced some years ago. The framework for e-filing needs to be further developed and to be able to accommodate existing practices (e.g., filing by tax representatives), so that e-filing of tax returns is possible, and even the norm, in most situations, as it is in other developed jurisdictions.

(d) As indicted in 1(a) above, further consideration should be given to need for more formal transfer pricing rules.

(e) Revision of the BOR structure and procedure. Problems with the existing arrangements were highlighted in the Court of Final Appeal case of *ING Baring Securities (Hong Kong) Ltd. v CIR* (2007) and a consultation was conducted by FSTB in 2008. However, changes have yet to be made.

Immediate budget measures

The Institute welcomed a number of the measures and proposals announced in last year's budget, several of which accorded with recommendations made by Institute, such as the stamp duty waiver on exchange traded funds, adjustments to the allowances for dependent parents and grandparents and the proposal to study interest expense reductions for treasury operations. We hope that the result of the study on treasury operations will be announced in the coming budget, along with some specific measures.

This year, we recommend the budget measures below to help strengthen the economy and support the community:

3. Profits tax measures

While the general profits tax rate should remain at 16.5%, the Institute proposes the following measures for businesses:

(a) The corporate profits tax rate should be reduced to 15% for companies whose gross income does not exceed HK$5 million. This would benefit the small and medium enterprises sector, which constitutes a substantial part of the economy and employment and which, generally, finds it more difficult to cope with the rising prices and costs of compliance.

(b) The business registration fee should be waived for 2015-16. The local and the Mainland economies continue to grow at a slower pace and the political uncertainties in Hong Kong may also have some effect. This is a small and affordable measure, which again will be of most benefit to small businesses.

4. Asset management and financial services centre

The Institute proposes the following measures for the asset management and banking sectors, which are core financial services:

(a) While we welcome the proposed extension of the offshore fund exemption to private equity funds, we recommend that consideration be given to extending similar exemptions to certain Hong Kong-resident funds. This would put onshore and offshore funds on a more equal footing. Singapore, for example, offers concessions to Singapore-domiciled funds that meet certain criteria. (Appendix 2 indicates the salient features.)

(b) Following implementation of Basel III, Hong Kong banks were required to meet new capital requirements, which included Additional Tier 1 instruments. However, the uncertainty regarding the tax consequences of such instruments affects the competitiveness of Hong Kong's financial services. Other jurisdictions, such as Singapore, have acted to introduce tax changes to cater for these instruments. We recommend that the government review the current tax position and consider allowing deductions for the distributions on such instruments.

5. Innovation and technology sector

The Institute proposes the following measures to boost the innovation and technology sector:

(a) Deductions should be allowed for 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.

Subject to a suitable definition of what constitutes R&D, where R&D is conducted offshore, a 100% deduction should be allowed, as part of a more flexible regime than currently exists.

Currently, section 16B of the IRO restricts deductions for R&D to those 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 holds 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.

However, businesses commonly develop IP in house; engage with other associated companies in cost-sharing arrangements for IP; provide/ license IP to third party 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[1].

The entities that assume the risks and benefits of an R&D investment (investor) should be distinguished from the entities that are paid to provide R&D services (service provider). The investor is the entity that invests, directs the project, undertakes the risk and owns the resulting IP, whereas the service provider does not undertake any risk, acts under the investor's direction and may perform only a certain element of the project.

The service provider may be located offshore due to skills and cost considerations. However, the investors should not be disadvantaged for making commercial decisions of this kind and it is not in the interests of the development of Hong Kong's economy that they should be. The distinction outlined above is recognised in the tax systems of a number of other jurisdictions.

(b) Where the R&D is conducted in Hong Kong, "super deductions" of 150% of the actual cost incurred should be allowed. Similar deductions are offered in Australia, Singapore, the Mainland and the United Kingdom, among other places.

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

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

The Institute recommends the following measures to support families and the community, given the increasing cost of living, to help people to gain the necessary skill sets to succeed in a knowledge-based society, and also to plan better for their retirement:

(a) To assist the lower and middle income taxpayers, as incomes strain to keep up with rising cost of living, consideration should be given to widening the marginal tax bands from HK$40,000 to HK$50,000.

(b) It is commonly accepted that the statutory mandatory provident fund contributions, so far, do not provide an adequate nest egg for people's retirement. Debate has been going on and no doubt will continue on possible alternatives, such as a universal pension scheme. This is likely to continue in the future, yet, in the meanwhile, taxpayers are not given incentives to save more for their own retirement. If taxpayers, particularly from the lower to middle income groups can save more, this will put less

[1] 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

pressure on the public coffers in the long run, at a time when the population is aging quickly. Therefore, to encourage people to invest more in their retirement, taxpayers should be allowed additional deductions for voluntary contributions to their mandatory provident funds, of up to HK$60,000 annually. The contributions could be made taxable if withdrawn before retirement.

(c) To encourage people to invest in their education and training and to upgrade their skills, so as to increase their employment opportunities, the Institute recommends extending the scope of the application of the deduction for self-education expenses. We propose that any amount of a taxpayer's maximum allowance, which is not taken up by the taxpayer him or herself should be allowed to be taken up by the taxpayer's dependants. So, if the deduction limit of HK$80,000 is not fully utilised by the taxpayer, it should be permitted to be used for the self-education expenses of the taxpayer's spouse, for training to join or re-join the workforce, or the taxpayer's children between 18 to 25 years old, who are not in full-time education, and who are not taxpayers or do not earn enough to be able to claim the deduction in their own right.

(d) In recent years, increases in the allowances for children and other dependants have often not been in alignment with one another and have been given out at different times. For example, child allowances have increased by 40% since 2008-09, while allowances and additional allowances for dependent parents and grandparents have increased by 33.3% and for dependent siblings and disabled dependants by 10% only. The basis and rationale for these adjustments should be made more transparent. The level of the existing personal allowances for single and married persons, allowances for children, dependent siblings, dependent parents or grandparents, single parents and disabled dependants should be reviewed and rationalised. Thereafter, adjustments should be made on a more transparent basis and aligned, where appropriate. Where there is good reason for differential adjustments, this should also be made clear.

(e) Pending the above review, we propose that the allowances should all be increased broadly in line with inflation.

(f) We note that the government has very recently launched a consultation on a voluntary health insurance scheme and we welcome this as a basis for discussion within the community on this important topic. However, the issue of health care funding has been under discussion for more than 15 years, so we do not envisage that an insurance scheme will be implemented quickly. In any event, the Institute's proposal is not inconsistent with the general direction of the proposals put forward by the government. Our proposal is to encourage more efficient utilisation of both public and private health care services, by allowing taxpayers a deduction for the cost of private health care 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 a similar cap per dependant.

If there are any reservations about introducing this measure while the current consultation is under way, we would propose that the deduction be offered in the coming year and that it may be made subject to review annually.

Proposed measures for salaries tax (given certain assumptions about rationalising the allowances) are contained in Appendix 3, while the impact of the changes for a typical individual and family are in Appendices 4 and 5, respectively.

7. <u>Housing and utility measures</u>

The Institute proposes the following measures to provide some support for the community in terms of housing and utility costs:

(a) Many taxpayers cannot to afford to buy their own homes now and will not be able to do so in the foreseeable future. Therefore, we propose that taxpayers be given an allowance equivalent to the home loan interest deduction that can be claimed for rental payments in respect of a taxpayer's primary residence, subject to an annual limit of HK$100,000. Employees who are already claiming a housing allowance from their employers should not be eligible for this benefit.

(b) The Institute considers that the additional stamp duty measures, such as buyer's stamp duty and special stamp duty, are justifiable measures to discourage excessive speculation in the market, which has been a factor in private housing becoming unaffordable for many. However, these measures should be temporary in nature pending an increase in the land supply to meet housing needs.

Therefore, the Institute proposes that the government regularly review the effectiveness of the 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. If it is felt that, as a result of change in market conditions, or for other reasons, some further relaxation to the special stamp duty measures may be merited, we would suggest that the government look first at allowing more time for property owners who are moving within the secondary market to sell their original property and still be eligible for refund of the additional stamp duty. This is because the amendments made to the Stamp Duty (Amendment) Bill 2013 during its passage, which aimed to allow more time for homeowners to sell their existing property if they were buying an uncompleted flat, due to long lead time between the signing of the agreement for sale and purchase and completion, may have had the incidental effect of favouring the new property market over the secondary market.

(c) In order to help lower income groups and, given also the likely increase in the cost of electricity for the majority of users in Hong Kong in the coming year, we propose that the subsidy remain in place for a further year. We suggest that each residential electricity account should be granted an electricity charge subsidy of HK$1,800 for 2015-16. 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).

8. <u>Environment and social measures</u>

The Institute proposes the following measures to promote sustainable development and social responsibility:

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

(b) 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 supports those in the greatest need, but it also reduces the unnecessary disposal of usable food in landfills. This laudable work would benefit from policy support from the government, as it receives in many jurisdictions overseas.

Support could be in the form of tax incentives for companies to donate surplus stocks of good-quality food to charities that redistribute the food to target groups. Deductions could also be allowed for food donations of this kind. A variety of different tax reliefs are in place in other jurisdictions. As there are currently no general landfill or waste disposal charges in Hong Kong to discourage disposal of unused food, the deductions could be based on the original cost of the food plus, say, 20%.

Hong Kong Institute of CPAs
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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. Below are examples of the areas that need attention:

1. 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:

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

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

   (c) 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.

2. Taxation of unrealised gains

   Following the recent decision of the Court of Final Appeal in *Nice Cheer Investment Ltd. v CIR*, the tax treatment of unrealised gains was made clearer. However, the court's judgment differs from the approach adopted by the IRD since the case of *CIR v Secan Ltd & Ranon* Ltd, more than 10 years ago, 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. It is now time to make the position clear once and for all.

3. Distinction between revenue and capital

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

   (a) 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.

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

4. 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:

(a) 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.

(b) 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, 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. This continuing uncertainty about the status of losses can also complicate discussions between taxpayers and their auditors, as it is also not clear whether such losses can be booked as deferred tax assets.

5. 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 SMEs, which constitute 98% of business establishments.[2] 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.[3] 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, United States, Australia and Singapore, for example, successfully operate group loss relief systems.

6. 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 be carried forward only for setting off against subsequent profits of that company. We note that the government considers that loss-carry forward should be able to assist enterprises to manage their losses.[4] However, the effectiveness of

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

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. The lack of loss carry-back also discourages businesses from investing and testing the water, prior to implementing more extensive expansion plans. Where, for example, the taxpayer ends up sustaining losses while gauging the longer-term viability of expansion, a facility for loss carry-back can help to relieve the financial burden relating to the investment plans.

7. Board of Review

We recommend that a full-time panel, comprising individuals with extensive tax expertise, be established to hear the more complex tax cases before the 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 certain deficiencies in the current BOR arrangements.

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 other BORs to hear non-complex cases, which would ensure cohesion in the administration of this part of the tax system, and that the decisions of previous BORs, would be more likely to be followed or distinguished.

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 a 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 a 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[5]
• Married person	240,000	252,000[5]
• Child – annual (for each dependant)	70,000	73,500[5]
• Child – initial (for each dependant)	70,000	73,500[5]
• Dependent brother or sister (for each dependant)	33,000	44,100[6]
• Dependent parent/ grandparent (for each dependant)		
- aged 60 or above or is eligible to claim an allowance under the government's disability allowance scheme	40,000	44,100[6]
- aged 55 or above but below 60	20,000	22,050[6]
• 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	40,000	44,100[6]
- aged 55 or above but below 60	20,000	22,050[6]
• Single parent	120,000	126,000[5]
• Disabled dependant (for each dependant)	66,000	88,200[6]
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

[5] Proposed allowances are increased under the assumption that the benchmark is set at current levels and an inflation rate of 5%.
[6] Assume proposed allowances are increased in line with the percentage increases in child allowances since 2008-09 and a current 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:[7]

- 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, and
- a deduction of rental payment with annual limit of HK$100,000.

	Existing (HK$)		Proposed (HK$)		Dollar savings (HK$)	Per-centage savings
	2014-15		2015-16			
Income		300,000		300,000		
Allowance/ deduction:						
Basic allowance	120,000		126,000			
Mandatory MPF contribution	15,000		15,000			
Voluntary MPF contribution[8]	-		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%

[7] Assumptions, as for Appendix 3.
[8] Assume annual voluntary MPF contribution of HK$15,000 (or monthly voluntary MPF contribution of HK$1,250).

Appendix 5

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:[9]

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

	Existing (HK$)				Proposed (HK$)				Dollar savings (HK$)	Per-centage savings
	2014-15				2015-16					
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	80,000 per parent	2 parents	160,000		88,200 per parent	2 parents	176,400			
Mandatory MPF contribution			17,500				18,000			
Voluntary MPF contribution			-				60,000			
Private healthcare insurance			-		12,000	1 taxpayer and 2 children	36,000			
Total allowance				437,500				563,400		
Net chargeable income				162,500				36,600	125,900	
Tax payable				15,625				732	14,893	95%

[9] Assumptions, as for Appendix 3.