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8 July 2009

Mr. Steve Ong
Director, Standard Setting
Hong Kong Institute of Certified Public Accountants
37/F., Wu Chung House
213 Queen's Road East
Wanchai, Hong Kong

Dear Steve,

Subject: Exposure Draft to Replace IAS/HKAS 12 (Income Taxes)

It has been one year since I last wrote to HKICPA on the subject of Recognition of Deferred Tax Liability under HKAS 12 by Entities in Hong Kong on Revaluation of Investment Properties for the purpose of HKAS 40. I attended the Financial Reporting Forum yesterday on IASB Exposure Draft on Income Tax. It was very nice meeting with you on that occasion.

Since my main concern remains with the issue of deferred taxation on revaluation of investment properties located in Hong Kong, I wish to take this opportunity to vigorously urge the Institute to consider dealing with this issue in the following two way, in combination or alternatively:

1. Convince the IASB that it is a very unique situation in Hong Kong that there is not any form of tax on capital gains, including profits arising from sale of investment properties. Moreoever, whether the investment properties are erected on freehold land or leasehold land is totally irrelevant. We should emphasize that such profits (and surplus on revaluation for the purpose of HKAS 40) are non-taxable at all. By the same token, gains on disposal of shares held for long term or strategic investments (as well as other assets with potential for appreciation in value over the long term, e.g. trade/brand names, goodwill, patents, etc.) are also non-taxable. The issue of deferred taxation on investment properties is singled out simply because there is a separate and special accounting standard for Investment Properties.
2. Adopt a common-sense approach in applying the IAS/HKAS 12. The underlying principles are more important than the words literally. Just as much as there are varying tax rates for Profits Tax, Salaries Tax, Property Tax, etc. in Hong Kong, if we do have to recognize deferred tax liability on change in value of investment properties due to fair value measurement, I strongly recommend that HKICPA consider the concept of "zero" tax rate for this purpose as a compromise. The surplus arising from revaluation is recognized for deferred tax recognition, and with the application of a zero tax rate to the "taxable" profit, the provision for deferred tax is then zero.

According to statistics prepared by HKEx, property companies in Hong Kong are the third largest sector in terms of market capitalization (at any given time). In addition, there are also a number of unlisted but sizable property companies, for example Chinachem. Their financial reports for the years since 2005 have been materially and persistently distorted by the application of HKAS 12. As a results, after-tax profits and net assets value have been significantly understated, and the use of their financial reports for investment decision is limited. This has defeated the paramount purpose of enacting the Accounting Standards. The need for solving this anomaly is therefore extremely pressing and cannot be further delayed. Failure to take necessary steps by the Institute will cause the reputation of Hong Kong as a major international financial center continue to be tarnished, and the Institute's ability to deal with similar key technical issues questioned.

Your truly,

Joseph S. Tam

Copies to: Ms. Winnie Cheung, Chief Executive, HKICPA
Mr. Paul Winkelmann, Chairman, Financial Reporting Standards Committee, HKICPA