Budget forum 2010-11 on 24 February 2010 at the Institute's Training Centre

Summary of discussion

1. In the budget day forum at the Institute, the discussion ranged over a wide area. In his presentation, and in answer to questions, Prof. KC Chan, secretary for financial services and the treasury (SFST) made a number of points including the following:

    - He hoped the community would see the present financial secretary's third budget as a pragmatic budget. The direction to be taken this time was less clear cut, unlike the previous budget, which of necessity had to be a stimulus budget.

    - One theme of the budget was promotion and stimulation of the capital market, including measures for the asset management industry, offshore funds and reminbi business. Legislation on Islamic financing was under preparation.

    - Tax measures were used to help industry, e.g., reduction in stamp duty on exchange traded funds and extension of concessions for the acquisition of intellectual property (IP).

    - Optimising land use was another important area and the budget included measures to revitalise old industrial buildings.

    - Capital spending would be high over the coming few years, resulting in projected deficits before returning to a balanced budget in 2013-14.

    - During this period, the fiscal reserves would drop to around 15 months of government spending. There was no magic number for the level of reserves, but healthy reserves were needed to fund relief measures. The International Monetary Fund had advised that, given the narrowness of Hong Kong's tax base, reserves of at least 12 months' expenditure should be maintained. In addition, returns from investment of the reserves constituted a significant source of recurrent income. If the reserves were reduced, this source of income would also be affected.

2. Reflecting on the budget as a LegCo member, Paul Chan made a number of points, including the following:

    - In terms of its coverage of Hong Kong's social, as well as economic development, this budget represented a step forward.

    - The community remained concerned about the wealth gap, although this was a problem in many economies. He was particularly concerned about the living conditions of the lower income group. Despite increases in per capita GDP over the past decade their take-home income had decreased.

    - The extension of tax concessions for IP and the financial services sector were a welcome response to recommendations made to the government.

- Tax experts were needed in the policy bureau to deal with concerns such as improving certainty in the tax system and resolving the issue of allowances for plant and machinery under section 39E of the Inland Revenue Ordinance.

- Hong Kong should observe what its competitors were doing, without necessarily copying specific measures. The recent Singapore government budget had introduced some creative measures, including 200% deductions (with a cap) for IP expenditure, 250% deductions for training, tax relief for "angel investors" to encourage investment in SMEs.

- Loss carry back was also an area where something could be done to assist business without leaving the door open too widely, given the government's concern about possible abuse.

- While people were generally happy with the salaries tax rebates and rate waivers, he felt they could be more targeted. Standard rate tax payers might not need these reliefs.

- The increase in stamp duty on property costing more than HK$20 million would not have much effect. The risk of speculation would be better dealt with through increasing land supply and other supply side actions.

- Mortgage interest relief could be extended beyond 10 years and, when conditions permitted, the government could consider other measures, such as first-time buyer loans.

- The latest round of the university matching grant scheme was welcome but more money should be allocated to it.

- The fiscal reserves, which now stood at around 21 months of expenditure, were excessive. The reserves should not be built up with the aim of generating significant investment returns, as the private sector was a more efficient investor. The government should instead look at directing more resources to key services, such as health care and education.

3. Florence Chan highlighted the main proposals in the Institute's budget submission and the rationale behind these, including the following:

    - Allowances for dependants should be increased by 20%. Apart from child allowances, most other dependants' allowances had not been increased for 10 years or more.

    - Other salaries tax proposals aimed at assisting the middle-income group included extending the period of the home loan interest deduction and introducing a new deduction of up to HK$12,000 per person for private medical insurance.

    - Hong Kong needed to attract talent, but the present regime for taxing the income of people employed in Hong Kong who worked across the region was not conducive to this. These employees should be taxable according to where their services were rendered and be taxed in Hong Kong only on the basis of days spent here.

- The competitiveness of Hong Kong's tax system needed to be examined. There was scope for:

  - 0.5% reduction in profits tax.
  - clarification of the rules on source of profits to improve certainty.
  - reducing the period for the finalisation of tax affairs to three years after the relevant year of assessment.
  - introduction of rules on transfer pricing, in relation to transactions between associates. The IRD had issued a departmental interpretation and practice note, but currently there were no rules with legal standing.
  - introduction of group relief and loss carry back, which could help businesses with their cash flow, particularly where they might have been taxed on unrealised gains.

- In relation to support for pillar industries, the undertaking to review the definition of central management and control for offshore funds was welcome. There was also scope for giving concessionary tax rates for onshore funds, as in Singapore and other markets.

- For new industries, the extension of the tax concession for IP expenditure was supported and in line with the Institute's proposals. Super deductions should be given to encourage research and development spending. The government's rebate scheme was too limited to significantly boost this area.

- Given the limited number of double tax treaties (DTAs) that Hong Kong had signed so far, a unilateral tax credit on royalty income arising in non-DTA jurisdictions should be considered.

- Measures to support Hong Kong's role as a treasury centre for group businesses would cost little in terms of lost revenue and would create a positive perception.

- On the question of import processing arrangements and section 39E, while the Institute understood the IRD's interpretation of the legislation, it was time to look at the issue from the policy perspective.

- Overall, the Institute believed that its proposals would stimulate the economy, improve Hong Kong's competitiveness, and so increase revenue.

4. Questions raised at the forum also touched on the progress with negotiating DTAs and the tax base. Prof. Chan said that progress on negotiating DTAs with major trading partners was good and subsidiary legislation would soon be put to LegCo.

5. Referring to comments made in the budget speech, the forum chair Ayesha Macpherson asked whether, in future, rather than renewing the debate on broadening the tax base, the government would rely on building up large reserves to deal with any challenges. Prof. Chan indicated that it was still desirable to broaden the tax base, although it would remain a challenge to gain community support.

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