



THE TAXATION INSTITUTE OF HONG KONG

(Incorporated in Hong Kong as a company limited by guarantee)

9 March 2005

The Hon. Bernard Chan
Chairman, LegCo Panel on Financial Affairs
Legislative Council Building
8 Jackson Road
Central
Hong Kong

Dear Mr. Chan

REVIEW OF THE INLAND REVENUE ORDINANCE ("IRO")

Our Institute has been asked by the Hon. Mandy Tam, legislative councillor for the accountancy constituency, to consider whether there is a need for the Government to conduct a review of the IRO.

Based on a number of general observations below, we believe that it is the right time for such review to take place and, without delving into unnecessary technical details, we have come up with a few broad areas where we believe the review should address.

IRO is generally an antiquated piece of legislation

The last review of the IRO was conducted in 1976 (i.e. almost 30 years ago) and although there have been amendments to the IRO from time to time, there is no substitute for a comprehensive review.

Indeed, even without the issues we identified below, a review undertaken for its own sake is totally worthwhile.

The IRO has been amended many times since 1976 whenever there is a change in the fiscal policy or where a technical issue arises which render amendment necessary. In patching up the IRO on an *ad hoc* basis, we might have lost sight of the general philosophy of the tax policy in Hong Kong - a simple and easy-to-follow tax system.

In addition, the IRO is arguably the most important piece of legislation responsible for government revenue collection. With the contraction of our tax base due to changes in the ways taxpayers conducted their businesses, the structural changes in the Hong Kong economy (especially in the past decade) and the ageing of the Hong Kong population, the IRO will need to be looked into from a macro economic policy prospective to see how it can better serve its original purposes.

A comprehensive review may, apart from addressing a number of specific areas which we will discuss below, have the following long-term benefits.

- Revamp the IRO into a piece of legislation which is consistently drafted and logically set out.
- Simplify the language used in the IRO which we feel is difficult in many parts even for the experienced tax practitioners.
- Create a formal committee with a clear mandate, resources, and expertise and most importantly, time to deal with the more fundamental and macro issues of the IRO, some of which we have highlighted in the preceding paragraph.
- Create a forum for the views of the professional bodies and public to be heard.¹

We have set out below a number of areas which we hope the review could address, each of these areas, we believe, is of such fundamental importance that only a specifically commissioned committee could achieve the task.

Uncertainties created by the source based profits tax regime

Inconsistent Board of Review and court decisions, inconsistent interpretation of the IRO by the Inland Revenue Department and the advent of new methods of doing business and technology all add complications to a fundamental issue which taxpayers, tax practitioners and the Inland Revenue Department have been facing for years.

We believe that the source based profits tax regime has brought clear competitive advantage to Hong Kong and it should be retained. However we would want to see the source rules codified. It is a difficult but nonetheless achievable task. Experience should perhaps be drawn from other jurisdictions where a source based or a quasi-source based regime has existed or still exist and to learn from their legislation.

Transfer pricing

Hopefully, with the source rule fixed, the Government should consider whether a set of more detailed transfer pricing rules should be created which can easily and consistently be applied.

Double taxation relief

As the Government is negotiating a number of full-scale double tax treaties, it is time perhaps to re-write this part of the IRO and to streamline all related provisions in the IRO concerning foreign tax suffered.

¹ Although the Joint Liaison Committee on Taxation (JLCT) exists as an unofficial advisory body to the Inland Revenue Department, we feel that the scope of work of the JLCT is more limited to technical issues.

We hope this initiative will attract wide support from professional bodies and the business sectors alike. If you need any further information or assistance from us, please do not hesitate to contact us.

Yours sincerely



Li Man Fai
President