

Information Note for Legislative Council Panel on Financial Affairs

Tax Treatment of Maintenance Payments

This paper sets out the tax treatment of maintenance payments under the Salaries Tax Regime and the rationale behind it.

Background

2. The Court of Appeal of the High Court in its ruling for a case in May 2002 commented that the policy of not allowing divorced persons paying maintenance payments to their ex-wives to claim Married Person's Allowance (MPA) seemed to be unfair and inequitable. The Courts quoted the United Kingdom's different practice in this regard. The Administration was requested by a Legislative Council Member to review whether the Inland Revenue Ordinance should be amended to permit a divorced taxpayer paying his or her ex-spouse maintenance pursuant to a court order to claim the MPA or to provide other tax relief, such as the introduction of a tax allowance for maintenance payments.

3. The Administration has given our views on the issue in replying to the Member's Question in July 2002. A copy of the Administration's reply is at *Annex*.

Married Person's Allowance

4. It has been our taxation policy to provide tax relief for taxpayers on payments made contributing to the maintenance or support of a relative, which means a person who has a relationship with the taxpayer established either by blood or by law, such as spouse (defined as a husband or wife), child, parent, grandparent, brother and sister, and so on. Where the husband and wife are living apart and the divorce has not yet become absolute, a taxpayer may still claim the MPA for contributions to the maintenance or support of his or her estranged spouse. However, when the divorce has become absolute, the taxpayer may no longer claim

the MPA. On the other hand, the alimony payments received by a former spouse are also exempt from tax. That is, the maintenance payment is neither taxed in the hands of the recipient nor allowed for deduction in the hands of the payer (i.e. symmetry of taxation). In the case of tax relief for spouses, consideration is always made as to whether the couple is married. For couples who are not married or have divorced, the MPA does not apply.

5. Hong Kong's tax treatment is in line with practices overseas, including the United Kingdom, Australia and New Zealand. In particular, it should be noted that the United Kingdom changed its system in 2000 by abolishing the tax relief for divorcees (except for a small number of old-aged taxpayers) while providing the tax exemption for maintenance payments received by former spouses.

6. We are aware that some jurisdictions like Singapore, the USA and Canada do allow relief for the payment of maintenance. However, on the other hand, these jurisdictions charge tax on the spouse who receives the maintenance. As maintenance payments do not come under the charge of salaries tax or any other income tax types under our schedular income tax scheme, it is logical not to allow tax relief for such payments, as in the UK, Australia and New Zealand.

Rationale for retaining existing policy

7. Introduction of a tax allowance for maintenance payments without charging tax in the hands of the receiver would lead to double benefits. Besides, it would be very difficult to verify whether a taxpayer has actually made alimony payments to his or her former spouse. For instance, if a divorced taxpayer who has not paid any alimony to his divorced spouse colluded with his former spouse, because they maintain a good relationship, and file a tax return claiming that the taxpayer had paid maintenance in a bid to claim an allowance, it would be impossible for the Government to verify the case and the Government would eventually suffer loss in tax revenue. Such a scheme would be difficult to implement effectively and would be prone to abuse.

8. It should also be noted that while a taxpayer may not claim MPA after divorce, the taxpayer may continue to claim the Child Allowance for payments made contributing to the maintenance or support of his or her children.

9. Unlike Singapore, USA and Canada, Hong Kong does not adopt a comprehensive income tax regime. Our scheduler income tax system only levies taxes on business profits under profits tax, property rental income under property tax and employment incomes under salaries tax. Maintenance payment between divorced couples does not fall within any of our taxing heads. If we are to adopt the tax treatment in those jurisdictions like Singapore, USA and Canada which allow relief for the payment of maintenance and charge tax on the spouse who receives the maintenance, it would mean either introducing a new tax type, or converting our taxation system into a comprehensive income tax regime in which income from whatever sources will be brought into charge of income tax. This is a fundamental change to our taxation regime, and hence not recommended.

10. The Administration considers the existing arrangement fair and does not see any strong justifications for change.

Financial Services and the Treasury Bureau
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SECRETARY FOR FINANCIAL SERVICES AND THE TREASURY (in Cantonese): Madam President, first of all, I wish to thank the Member for her question, as it gives the Government the opportunity to explain its policy on tax relief for maintenance payments.

- (a) It has been our taxation policy to provide tax relief for taxpayers on payments made contributing to the maintenance or support of a relative. "Relative" means a person who has a relationship with the taxpayer established either by blood or by law. Examples include spouse, child, parent, grandparent, brother and sister, and so on.

"Spouse" is defined as a husband or wife. Where the husband and wife are living apart and the divorce has not yet become absolute, a

taxpayer may still claim the MPA for contributions to the maintenance or support of his or her estranged spouse.

Although a taxpayer may not claim the MPA when a divorce has become absolute, the alimony payments received by a former spouse are exempt from tax. Also, the taxpayer may continue to claim the Child Allowance for payments made contributing to the maintenance or support of his or her children after divorce.

- (b) Referring to the United Kingdom's tax legislation, the Court of Appeal in its judgement on a recent case pointed out that some overseas tax jurisdictions do provide tax relief on maintenance payments and remarked that it seemed to be unfair and inequitable not to allow divorcees in Hong Kong to claim tax allowance for maintenance payments made to former spouses. However, I wish to point out that in April 2000, the Government of the United Kingdom has changed this system of providing tax relief on maintenance payments. It abolished the tax relief for divorcees, except for a small number of old-aged taxpayers, while retaining the tax exemption for maintenance payments received by former spouses. This is exactly the system being practised in Hong Kong and indeed in other overseas jurisdictions such as Australia and New Zealand.
- (c) I understand that there are cases in which the divorcees have not made maintenance payments in accordance with court order or have delayed making such payments. But I wish to point out that a tax allowance is unlikely to be an effective solution to such problems. Divorcees may fail to make maintenance payments as required by court order for various reasons, such as financial problem, being out of employment, or a bitter relationship with their former spouse. We think that introducing a tax allowance will hardly help in such situations.

Those who are not required by the Court to make maintenance payments would probably still not pay even if there is a tax allowance for these, as the benefits from a tax allowance are certainly less than the payment itself. Also, people who pay no tax

and taxpayers who are already paying at the standard tax rate will derive no benefit from such a tax allowance.

- (d) Also, such a tax allowance would involve many operational problems. It is administratively cumbersome to prevent double benefits due to tax exemption for maintenance payments received by the former spouse and to verify that a person has actually made alimony payments to his or her former spouse. This would be difficult to implement effectively and prone to abuse.
- (e) As a responsible Government, we encourage people to fulfil their obligations to their ex-spouses. However, we do not consider it appropriate or the most effective means to achieve this goal through tax incentives.