The Legislative Council Meeting on 20 November 2013
Motion on "Reducing taxes across the board"

Progress Report

Purpose

At the Legislative Council meeting on 20 November 2013, the following motion moved by Hon Paul TSE, as amended by Hon Kenneth LEUNG, Hon Jeffrey LAM and Hon YIU Si-wing, was passed -

> "That, as the economic pattern in Hong Kong is changing, this Council urges the SAR Government to expeditiously and comprehensively review the Inland Revenue Ordinance to make the tax regime of Hong Kong fairer, more competitive and certain; the SAR Government should also optimize the fiscal surplus and avoid excessive wealth accumulation, so as to achieve the objective of leaving wealth with the people; this Council also urges the SAR Government to introduce or increase tax allowances for education, healthcare, housing and maintaining children, so as to alleviate the financial burden of middle-class people; this Council also urges the SAR Government to initiate studies on improving the tax regime to increase the sources of financial revenue, and expeditiously roll out appropriate tax reduction measures."

This paper informs Members of the follow-up actions taken by the Administration in respect of the motion.

Simple Tax Regime with Low Tax Rates

2. All along, the Government manages public finances in a prudent manner in accordance with the requirements under the Basic Law. We practise a simple tax regime with low tax rates, and strive to uphold the taxation principles of fairness and neutrality.

3. In the light of the international development trends and Hong Kong's changing economic and social circumstances, the Government reviews the tax regime from time to time, including gauging views from various sectors of the community through different channels during the annual Budget consultation. Arising from such reviews, the Government implemented a number of tax measures to keep our tax regime in pace with

latest developments, with a view to maintaining the competitiveness of Hong Kong. Over the years, the Government put forward at different times the proposals of waiving hotel accommodation tax, exempting wine duty, exempting profits tax for offshore funds, abolishing estate duty, and exempting stamp duty for trading of exchange traded funds, so as to facilitate the further development of Hong Kong's industries with clear competitive edges. These are cases in point.

4. As widely recognised, Hong Kong's tax environment is among the best in the world. According to the "Paying Taxes 2014" published by the World Bank in late 2013, Hong Kong was ranked among the top in the world in terms of ease of paying taxes. Among the advanced economies, Hong Kong is also one of the places with the lowest total tax rate for businesses. These demonstrate that the simple and low tax regime in Hong Kong is a positive factor underpinning the competitiveness of Hong Kong enterprises and should therefore be maintained. In fact, in the year of assessment 2011-12, almost 90% of the registered corporations (i.e. about 770 000 companies) need not pay any profits tax, and the vast majority of tax-paying corporations pay only very little tax. The top 800 tax-paying corporations have contributed about 64% of our profits tax.

5. Similarly, for salaries tax, apart from adopting progressive tax rates, we also provide generous tax allowances. Taking the year of assessment 2011-12 as an example, the average effective tax rate for all salaries tax payers is only 8%, which is much lower than the standard tax rate of 15%. When compared with other economies, the average effective tax rate at 8% represents a very light tax burden. Of the 3.6 million working population, only 1.6 million people pay salaries tax, of which a small group (about 200 000 taxpayers) shoulders over 80% of the total salaries tax.

Tax Measures

6. On the premise of fiscal prudence and maintaining low tax rates, there is limited room for the Government to provide tax concessions. Nevertheless, the Government understands that the public face a lot of financial pressure in areas of housing, education and healthcare, and notes that there are various suggestions for the Government to consider introducing specific tax deductions so as to alleviate taxpayers' burden in rental and children education expenses. After taking into account the overall financial commitments and the fairness of resource allocation, the Government has responded to the various aspirations of the people by way

of adjusting the basic, child and dependent parent allowances under the existing simple tax regime. Indeed, the Government has kept the various existing tax allowances under constant review and proposed adjustments having regard to the social conditions and the Government's financial position, with a view to catering for the people's needs.

7. In the 2014-15 Budget, the Government has proposed a number of counter-cyclical, one-off relief measures. These include a one-off reduction of salaries tax, tax under personal assessment and profits tax for the year of assessment 2013-14 by 75%, subject to a ceiling of $10,000. The measure will benefit about 1.74 million taxpayers of salaries tax and tax under personal assessment and about 126 000 tax-paying companies and unincorporated businesses, while costing the Government about $10.2 billion.

8. Apart from the one-off measures, to alleviate taxpayers' burden in maintaining dependent parents or grandparents, the 2014-15 Budget has also proposed to increase the dependent parent/grandparent allowances and the deduction ceiling for elderly residential care expenses under salaries tax and tax under personal assessment. About 550 000 taxpayers would benefit from the proposals. The revenue forgone for the Government is about $300 million a year.

9. To implement the proposed tax measures as set out in paragraphs 7 and 8 above, the Government will introduce the relevant Inland Revenue (Amendment) Bill 2014 into the Legislative Council on 7 May 2014. The relevant measures will be implemented upon passage of the Bill by the Legislative Council.

Fiscal Reserves

10. To preserve fiscal sustainability, the Government has a responsibility to ensure that there are sufficient fiscal reserves to perform their major functions, including serving as a buffer during economic downturns, coping with unfunded liabilities and committed expenditures, generating investment income, strengthening the stability of Hong Kong dollar, and meeting future needs.

11. While upholding the fiscal discipline of keeping expenditure within the limits of revenues, the Government has always been committed to the expenditure that ought to be spent. From 2009-10 to 2014-15, the Government's total recurrent expenditure has increased by 39%, and the

recurrent expenditures on education, healthcare and social welfare have increased by 32%, 48% and 44% respectively during the same period.

12. In the long run, to explore ways for our public finances to cope with an ageing population and long-term financial commitments, the Government set up in June 2013 the Working Group on Long-Term Fiscal Planning. After performing a health check on the current state of Hong Kong's public finances, the Working Group released a report in early March 2014, making projections of the Government's long-term fiscal position up to 2041-42, having regard to demographic trends, economic growth and prevailing policies. According to the Working Group's analyses, the Government's overall fiscal position in the short to medium term remains healthy. In the longer term, however, to cope with the continuing challenges of an ageing population to public finances, the Government needs to adopt a multi-pronged approach to foster economic growth and align the growth rates of government revenue and government expenditure.

Preserving Revenues

13. We will introduce a series of measures to strictly control expenditure growth. The Government will also endeavour to preserve and stabilise revenues, such as continuing to review fees and charges in accordance with the "users pay" principle.

14. In the medium to long term, we need to explore how to broaden the revenue base. In the past, the Government conducted a number of tax policy reviews, including the setting up of the Advisory Committee on New Broad-based Taxes in 2000. The Advisory Committee conducted an extensive study on Hong Kong's tax regime and on ways to broaden the tax base. It also consulted the public on related matters. Subsequently, in 2006, the Government launched a public consultation on the proposal of introducing a Goods and Services Tax. Although members of the public were not yet ready to accept the introduction of the new tax at that time, during the consultation, they generally reckoned the need to address Hong Kong's narrow tax base and offered views on other options for broadening the revenue base. As to what options the Government should adopt, the public did not have any clear inclinations or mainstream views.

15. After implementing the measures for containing expenditure growth, the Government will re-visit past studies and consultation results on broadening the revenue base, and take the next step in reviewing the tax

regime taking into consideration the Working Group's projections. At this stage, the Government has no plan to introduce any new taxes or change the existing tax regime.

Financial Services and the Treasury Bureau
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