For discussion on
4 November 2013

Legislative Council Panel on Financial Affairs

Inland Revenue (Amendment) Bill 2014

PURPOSE

This paper seeks Members' views on the proposed amendments to the *Inland Revenue Ordinance* (Cap. 112) ("IRO") to –

(a) implement the 2013-14 Budget initiative to give captive insurers a concessionary profits tax rate (i.e. one-half of the normal tax rate of 16.5% for corporations) for their business of insurance and reinsurance of offshore risks; and

(b) increase the deduction ceiling for contributions[1] made by employees or self-employed persons to recognized retirement schemes subsequent to the increase of the maximum relevant income level ("Max RI") under the MPFSO from $25,000 (per month) to $30,000 (per month) with effect from 1 June 2014.

BACKGROUND

Proposed Tax Concession for Captive Insurers

2. Captive insurance is a form of self-insurance by companies.

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[1] Contributions include:
(a) mandatory contributions by a self-employed person under the Mandatory Provident Fund Schemes Ordinance ("MPFSO")(Cap.485);
(b) the lesser of the amount of the contributions paid by a person as an employee to a recognized occupational retirement scheme or the amount he would have been required to pay if at all times whilst an employee during the relevant year of assessment he had contributed as a participant in a mandatory provident fund scheme; and
(c) mandatory contributions by an employee to a mandatory provident fund scheme under the MPFSO.

In Hong Kong, a captive insurer is legally defined under the *Insurance Companies Ordinance* (Cap. 41) as an insurer which carries on general business only and is restricted to underwriting insurance and reinsurance of risks of the companies within the same group of companies to which the captive insurer belongs. A company may wish to set up a captive insurer to provide coverage of specific risks that is not readily available in the market. As a captive insurer can operate with a lower overhead (e.g. no marketing expenses and commission to insurance intermediaries) and profit margin, it may charge a lower premium and the parent company can also share the underwriting profits of the captive insurer.

3. While captive insurance has been widely used as a risk management tool in advanced economies, its utilization in Asia remains low. Attracting companies to set up captive insurers in Hong Kong to form a cluster will help the development of other related businesses, including reinsurance, legal and actuarial services, making Hong Kong's risk management services more diversified. This will in turn reinforce Hong Kong's status as a regional insurance hub. With a sound regulatory regime and availability of a wide range of professionals, Hong Kong is well positioned to establish herself as a domicile for captive insurers.

4. This potential is strengthened by the Central People's Government's policy to encourage Mainland enterprises to form captive insurers in Hong Kong to enhance their risk management promulgated by the State Council in June 2012 as one of the measures to foster co-operation between the Mainland and Hong Kong.

5. Against this background, the Financial Secretary proposed in the 2013-14 Budget to reduce the profits tax of captive insurers for their business of insurance and reinsurance of offshore risks such that they will enjoy the same tax concessions under the IRO as those currently applicable to reinsurers (i.e. at one-half of the normal corporation tax rate of 16.5% on the taxable profits derived from the business of reinsurance of offshore risks).

Increase the Deduction Ceiling for Contributions to Recognized Retirement Schemes

6. The IRO provides for deduction of contributions to recognized retirement schemes by employees and self-employed persons in the assessment of salaries tax, tax under personal assessment and profits tax. On commencement of the Mandatory Provident Fund

Schemes Ordinance (Amendment of Schedule 3) Notice 2013 on 1 June 2014, the Max RI will be increased from $25,000 to $30,000 per month. Following this, we propose to increase the deduction ceiling for contributions to recognized retirement schemes from $15,000 to $17,500 (i.e. $25,000 × 5% × 2 months + $30,000 × 5% × 10 months) for the 2014/15 year of assessment, and $18,000 (i.e. $30,000 × 5% × 12 months) from the 2015/16 year of assessment onwards.

WAY FORWARD

7. We plan to introduce the proposed legislative amendments into the Legislative Council in the first quarter of 2014. The proposed tax concession for captive insurers would be applicable to the year of assessment commencing on 1 April 2013 and all subsequent years of assessment. The increase of the deduction ceiling for contributions to recognized retirement schemes would be applicable to the year of assessment commencing on 1 April 2014 and all subsequent years of assessment.

8. Members are invited to offer views on the proposed legislative amendments.

Financial Services and the Treasury Bureau
25 October 2013