

24th April, 1947.

PRESENT: —

HIS EXCELLENCY THE GOVERNOR (SIR MARK AITCHISON YOUNG, G. C. M. G.)

HIS EXCELLENCY THE GENERAL OFFICER COMMANDING THE TROOPS (MAJOR-GENERAL G. W. E. J. ERSKINE, C. B., D. S. O.)

THE COLONIAL SECRETARY (HON. MR. D. M. MACDOUGALL, C. M. G.)

THE ATTORNEY GENERAL (HON. MR. J. B. GRIFFIN, K. C.)

THE SECRETARY FOR CHINESE AFFAIRS (HON. MR. R. R. TODD, *Acting*).

THE FINANCIAL SECRETARY (HON. MR. C. G. S. FOLLOWS, C. M. G., *Acting*).

HON. DR. P. S. SELWYN-CLARKE, C.M.G., M.C. (Director of Medical Services).

HON. MR. T. MEGARRY.

HON. MR. V. KENNIFF (Director of Public Works).

HON. MR. D. F. LANDALE.

HON. MR. CHAU TSUN-NIN, C.B.E.

HON. MR. LO MAN-KAM, C.B.E.

HON. MR. R. D. GILLESPIE.

HON. DR. CHAU SIK-NIN.

HON. MR. M. M. WATSON.

MR. D. R. HOLMES, M.B.E., M.C. (Deputy Clerk of Councils).

ABSENT: —

HON. MR. LEO D'ALMADA E CASTRO.

MINUTES.

The Minutes of the meeting held on 10th April, 1947, were confirmed.

PAPERS.

THE COLONIAL SECRETARY, by command of H.E. the Governor, laid upon the table the following paper: —

Report of the Committee appointed to examine the Inland Revenue Bill.

MOTIONS.

THE ATTORNEY GENERAL moved—

That the amendment made by the Urban Council on the 15th day of April, 1947, under section 5 of the Public Health (Food) Ordinance, 1935, Ordinance No. 13 of 1935, to the by-laws under the heading "Markets" and sub-heading "Market Stalls" contained in the Schedule to the said Ordinance, be approved.

He said: As Council is aware, by Section 7 of the Public Health (Food) Ordinance it is necessary that any by-laws made by the Urban Council should receive the approval of this Council. The purpose of the amendment is to add the Superintendent of Agriculture and the Officer in Charge of Fisheries to the list of persons who are entitled to free access to every part of every market building.

THE COLONIAL SECRETARY seconded, and the motion was carried.

INLAND REVENUE BILL, 1947.

THE FINANCIAL SECRETARY moved the First reading of a Bill intituled "An Ordinance to impose a Tax on Earnings and Profits." He said: It would be idle to pretend that there has not been a great deal of opposition to this Bill and doubtless Honourable Members will have a good deal to say about it in the course of the debate on the Second reading. This afternoon I propose to confine myself to a detailed explanation of the measure and I hope to demonstrate that the amendments which have recently been made in it will at least render the Bill more palatable to the community as a whole, and also remove most of the objections which have been advanced against it.

Honourable Members will recollect that in September 1946 Your Excellency appointed a Taxation Committee to review taxation generally with the object of reducing as rapidly as possible our dependence on His Majesty's Government for financial aid. In particular the Committee was asked to consider the desirability of replacing the War Revenue Ordinance, which is still on the Statute Book, by the introduction of a tax on incomes.

The Committee agreed that such a tax would theoretically result in the most equitable distribution of the burden of taxation, and they expressed the view that taxation of this kind was inevitable if the

Budget was to be balanced. They considered that any income tax legislation must be as simple as possible and that some departure from general practice elsewhere would be necessary. They therefore recommended that the War Revenue Ordinance should be completely recast and with this object in view Mr. Pudney, who has since been appointed Commissioner of Inland Revenue, was sent to London to consult with experts of the Department of Inland Revenue there.

The Bill which is now before Council represents the results of these consultations but it has been modified in a number of respects since it was first published for general information on the 7th March. Following that publication, the Taxation Committee was invited to express their views on the Bill and for this purpose the Committee was augmented by the inclusion of all the Unofficial Members of this Honourable Council. The Unofficial Members of the Committee agreed in principle that direct taxation should be imposed, but expressed themselves as being in favour of postponement of the operation of the tax until a future date. The view was also expressed by all except three of the Unofficial Members of the Committee that in their opinion it was imperative that the standard rate should be low and that it should not exceed ten per cent. They also considered that the Bill required more detailed examination than had hitherto been possible, and that it should be referred to a Committee for further examination.

This Government has accepted the views of the Committee in regard to the standard rate, and the figure of ten per cent. has now been inserted in the Bill. They have not been able to accept the recommendation in regard to the postponement of the tax but they did refer the Bill to a further Committee for detailed examination. That Committee, which was under the chairmanship of the Honourable Mr. Arthur Morse, was particularly well qualified for the task as it numbered among its members bankers, lawyers and chartered accountants.

The Committee submitted a very valuable report, a copy of which has been laid on the table this afternoon. All the recommendations made by the Committee have been accepted by Government, but before dealing with these modifications of the original draft, I think it might be well to outline briefly the main features of the Bill itself.

When the Bill was being drafted in London an endeavour was made to incorporate some of the more advantageous features of a normal form of income tax without departing too much from the underlying principles of the 1941 Ordinance. Above all the aim was simplicity but as in the 1941 Ordinance, four distinct taxes—a Property tax, Salaries tax, Profits tax and Interest tax—have been provided for and each is dealt with in a separate chapter of the Bill.

The 1941 Ordinance differed essentially from normal income tax legislation in that the basis of the tax was the source of income instead of the individual. Only in the case of the Salaries tax was there provision for individual assessment. In the case of the other taxes

a somewhat rough and ready effort was made by means of rebates and reduced rates to apply something equivalent to personal allowances without the disclosure of personal interests. In view of the infinite variety of personal interests and circumstances, such a system cannot in practice work out equitably and if is not suitable for inclusion in permanent legislation. In the present Bill provision has been made in the case of the Property tax, Profits tax and Interest tax for the application of the standard rate, but under Chapter VII any person may elect for personal assessment and so obtain the benefit of the various personal allowances. No detailed provision was included in the 1941 Ordinance for depreciation and none at all for the carrying forward of losses. These matters have been provided for in Chapter VI and Section 20 of the present Bill.

In the case of the Salaries tax a graduated scale of tax is provided for under Section 14, the rates on chargeable income varying from a quarter of the standard rate by steps of \$5,000 to twice the standard rate.

Provision for deductions to be made in respect of life insurance premiums and Widows and Orphans Pension payments has been made under Section 43 (d) of the new Bill. Such deductions were not provided for in the 1941 Ordinance. No provision is made for any form of surtax as this is impracticable where there is no universal personal assessment.

Those then were some of the principal features of the Bill as originally drafted. The Committee under the chairmanship of the Honourable Mr. Arthur Morse to which it was referred for consideration in detail has, as Honourable Members are aware, made a number of useful recommendations and I should like to say how much Government is indebted to members of that Committee and to the Chairman in particular for the very valuable work which they have put in. All their recommendations have been acceptable to Government and are incorporated in the Bill now before the House. I propose to refer briefly to the most important changes which have been made as a result of the Committee's report.

It was originally proposed to tax income arising in, derived from, or received in the Colony. The Committee has recommended that tax should be restricted to income arising in or derived from the Colony. This is the same basis of taxation as in 1941 and on the whole the amendment proposed by the Committee appears to be justifiable. This Colony differs from the majority of colonial dependencies in that a number of head offices of important businesses are established here. Profits resulting from business activities in other countries must pass through the books of the head office and if such profits were taxable here all sorts of complicated claims in respect of double taxation would arise. The Committee felt that this might tend to discourage firms from establishing their head offices here and that Hong Kong's position as a financial and commercial centre might be adversely affected.

The normal practice is to assess tax for the current year on the actual income of the previous year and the Bill was originally drafted on these lines. The Committee has recommended that taxpayers should be given the option of having their assessment reduced to the actual earnings or profits for the year 1947/48. Such a concession would of course only apply to this particular year and the previous year basis would be reverted to in the future. The effect therefore would be that where a taxpayer opted to take the profits for 1947/48 as the basis of assessment instead of those of the previous year, the 1947/48 profits would in practice form the basis of assessment for two years running.

There are always objections to retrospective taxation and, in accepting the recommendation of the Committee, Government was influenced by the fact that the profits earned in 1946/47 have been used to a considerable extent in making good losses arising from the war. There was a proposal that some provision should be included for the setting-off of war losses against profits, but the Committee felt that it would be impossible to devise any measure of relief which would cover satisfactorily both business losses and losses of personal property. The option in regard to the basis of assessment goes some way towards meeting the question of war losses.

Before the Bill was referred to the Committee, Government had received certain representations from property owners who felt that some concession should be granted to them in respect of the Property tax in view of the fact that owing to rent restriction legislation they had not been able to recoup themselves in regard to their war losses in the same way as members of the business community. The Committee was therefore particularly requested to consider whether the tax, if imposed at the full rate, would cause hardship. They came to the conclusion that some degree of hardship would be caused and they recommended that only half the standard rate should be charged during such time as rents continue to be restricted to December 1941 levels. The Committee also expressed the view that the allowance for repairs should be increased from ten to twenty per cent.

As a result of their consideration of the Salaries tax section of the Bill, the Committee recommended that the scope of the tax should be widened to cover annuities as otherwise individuals would be able to take out annuities for large sums and to enjoy the revenue therefrom free of tax. Certain omissions which were noticed just before the Bill was originally published but which were not corrected then in order to avoid delays in printing have now been provided for. These include the exemption from tax of wound and disability pensions and war gratuities paid to members of His Majesty's forces. This is the normal practice. Provision has also been made for the exemption from tax of the emoluments of members of His Majesty's forces. If such an exemption were not included much unnecessary work would result in the way of claims in respect of double taxation.

As I explained earlier, the Salaries tax is on a graduated scale rising to double the standard rate. Now a member of a business firm who is paid partly in the form of salary but principally by participating in the profits would naturally not elect to be personally assessed. He could not therefore be charged at a higher rate than ten per cent. on his whole income. It would not be fair if a person whose emoluments consisted solely of salary had to pay tax at a higher rate, and in order that there may be no inequity the Committee has recommended the insertion of a proviso to the effect that in no case shall Salaries and Annuities tax exceed the amount which would have been charged had the standard rate been charged on the whole income before the deduction of any allowances.

In considering the question of personal allowances, the Committee gave special consideration both to the representations from the Chinese community and to the fact that a very large section of the European population is compelled owing to lack of alternative accommodation to reside in hotels. The absolute minimum living costs of this very considerable section of the community are very high, and it seemed only reasonable therefore that this factor should be taken into consideration in determining personal allowances. In these circumstances the Committee recommended that the personal allowance should be increased to \$7,000, while that for a wife should be increased to \$5,000. In recommending these increases the Committee felt that they were also meeting to a large extent the representations which had been received from the Chinese community in regard to the inclusion of a dependants' allowance. This presents peculiar difficulties in view of the obligation imposed by Chinese law and tradition for the maintenance of dependants in addition to children, but it was felt that as the standard rate of tax is very moderate and as the personal allowance had been fixed on an artificially high level, dictated by local housing conditions, no real hardship would result if no specific relief were given in respect of dependants other than children.

The Committee also considered representations for the grant of allowances to children beyond the fourth and recommended an allowance of \$200 for each subsequent child provided that the total allowance in respect of children does not exceed \$7,000.

Section 20, providing for the set-off of losses, has been amended on the recommendation of the Committee. It was originally provided that such set-off should not reduce the tax payable to less than half the amount due. Such provision is common practice in colonial income tax legislation in order to safeguard the revenue in colonies whose whole economic structure is dependent on one agricultural crop or the market for some particular mineral. There is no such limitation in the United Kingdom and as Hong Kong's economy does not depend on the market for any one commodity, the Committee recommended that no limitation on the extent to which losses could be set off should be imposed in this Colony either.

A number of petitions against the enactment of the Bill have been received by Government. These have been carefully considered by Your Excellency and your advisers. They have also been circulated to members of Executive Council. Some of the points raised have been met by amendments now incorporated in the Bill. Others, such as the rather widespread impression that Government will compel traders to keep their accounts in European form, are the results of a misunderstanding. The new Department of Inland Revenue will have officers capable of investigating and assessing Chinese accounts, and there is no intention that any pressure should be exerted to have accounts kept in European style. Then it has been suggested that the imposition of income tax will drive capital away from the Colony and prevent new capital from coming in. I doubt if any of those who signed these petitions would seriously consider the transfer of their capital to any neighbouring territory at the present time.

There is also, I fancy, some misconception in regard to the exact effects of the new Bill, and, before concluding, it might be desirable for me to quote a few examples of actual tax payable by families of different sizes in the various income groups.

A single man pays no tax if his income is under \$7,000, and a married man with no children would not pay unless his income exceeded \$12,000. A single man with an income of \$10,000 would pay \$75 tax and if his income were \$16,000 he would pay \$325. A married man with an income of \$20,000 and no children would pay \$275. If he had two children he would pay \$100 and if he had 4 children he would only pay \$50. With an income of \$30,000 a single man would pay \$1,625, a married man with no children would pay \$1,050 while with two children and four children the amounts payable would be \$675 and \$525 respectively.

These figures show that the effects of the new measure are by no means as onerous as many of the critics have represented.

THE COLONIAL SECRETARY seconded.

H.E. THE GOVERNOR. —Honourable Members of the Legislative Council, It is natural that the Bill which is now before the Council should have aroused widespread interest in the Colony. It is also perhaps not unnatural that it should have given rise to a very considerable volume of opposition and to a large number of protests.

Now I am not going to suggest for a moment that this opposition to the proposals which are now before us and these protests against the passing into law of the Inland Revenue Bill are simply due to the ordinary human being's dislike of taxation in any form. That is quite clearly not the case. I have not found, and I do not think that there is to be found in this Colony, any unreasonable objection on the part either of firms or of individuals to paying a fair share of

their income, from whatever source it may be derived, for the maintenance of essential services, for the discharge of our obligations, and for the recovery of all the actualities and the potentialities that the tragedy of recent years has taken away from the community as a whole.

No; we recognize that the opposition is due to a conviction held by many people in this Colony, that this is not the best or the most appropriate form of taxation for Hong Kong. The Council will expect me to be perfectly frank on this point, and I have to say quite frankly that the Government is of a contrary opinion. The Government has taken into its consideration all the representations that have been made on this point and it remains of the opinion that a measure of direct taxation is the most appropriate method of providing for some of the essential expenditure of this Colony in present circumstances.

I want to make it quite clear that this is not a mere doctrinaire opinion hatched out by a Governor or a Financial Secretary in the privacy of his office, nor yet an opinion imposed upon this Government from without, regardless of local opinion and local conditions. It is a conclusion at which the Government did not arrive until it had called into being a Taxation Committee composed of twelve persons, including its Secretary, of whom only three persons, again including the Secretary, were officials. That Committee was asked to make a specific recommendation on the subject of the introduction of an Income Tax and it was in accordance with their recommendation that this Bill was first framed, and published, as Honourable Members know, some seven weeks ago with an explanatory memorandum in which the terms of the Taxation Committee's recommendation were set out.

My Honourable friend the Financial Secretary has given an account in some detail of subsequent developments, which have resulted in very considerable modifications being made in the Bill.

It was, as Honourable Members know, the result of a second reference to the Taxation Committee, enlarged by the inclusion in its number of all the Unofficial Members of this Council, that the standard rate has been inserted in the Bill at the figure—the not unduly onerous figure, may I say—of ten per cent.

And as a result of a reference to another Committee—to which I may say, as the Honourable Financial Secretary has already said, both the Government and the Council are under a great debt of obligation—it is as a result of this reference that various changes have been made in the terms of the Bill, all designed to obviate possible hardships in its operation.

I hope that enough has been said both by the Honourable the Financial Secretary in introducing this Bill, and by myself, to satisfy the Council firstly that these things are not being done in a corner, and secondly that they are not being done with undue or unreasonable rapidity. Nine months have elapsed since this Council was informed

by the Financial Secretary that the Government had under consideration the question of the date from which direct taxation under the old War Revenue Ordinance should be collected and also the question whether the provisions of that Ordinance should be replaced by a more normal form of Income Tax Law, and more than seven months have passed since another clear indication was given by myself to this Council of the fact that the Government would have to consider the re-introduction in this post war period of a measure of direct taxation. During the past seven weeks this Council and the public have had an opportunity of studying and commenting upon the proposals embodied in the Bill, an opportunity of which full advantage has been taken and which has resulted, as I have explained, in substantial modifications being made in its terms.

There is one more thing, which I think I ought to say on the subject of the programme which we are following in dealing with this measure. Hitherto, as I have said, sufficient time does appear to me to have been allowed for consideration of the measure. Hereafter also I hope that Honourable Members will find that the time given to them for study of its terms and for consultation is sufficient. But here I do feel that in some sense time does press. It is proposed that the second reading of this Bill shall be taken on the 1st May, that is to say, on this day week. And the reason for this is twofold. In the first place a month will already have passed since the commencement of the financial year in respect of which it is proposed that this revenue measure shall operate, and for administrative reasons it is desirable that the measure shall be upon the statute book not much after that date; and secondly I am acutely conscious of the fact that the time for my own departure from Hong Kong will by then be drawing very near. Honourable Members will, I am sure, understand me when I say that I do consider it to be my duty to this Colony to see that the question does not remain undetermined at the time of my departure. I should not put this forward as a reason for proceeding with any undue precipitancy, in this or in any other matter, and I sincerely trust that no Honourable Member will in fact find that the interval between first and second reading is embarrassingly or inconveniently short. If it should prove to be so I shall hope nevertheless to have that Honourable Member's understanding and indulgence.

The reasons for the introduction of this Bill are, quite simply, that the revenue is needed, and, as I have explained, that of the various possible methods of raising this revenue the methods embodied in this Bill are considered—not by the Government's financial advisers only—to be the most appropriate.

As regards the need—it may be said, in fact it has been said, that our other revenue estimates have been framed on a conservative basis, that they are sure to be exceeded, and that we can quite safely enter upon the expenditure of 1947-48 without making provision in our Revenue estimates and our Revenue legislation for quite the full

amount which is required. I do not believe that many thinking people can really hold that such an attitude of optimism would be justified at the present time, or that we ought to depart at this juncture from a policy of conservative finance.

We do not know how long the present relative buoyancy of revenue will continue: we do not know how soon or at what point the demand for consumer goods will materially slacken. But what we do know is that the area in which we live is in a state of flux. Over the past twelve months our aggregate revenue has certainly been healthy: but we have observed considerable fluctuations in the yield from month to month. And if revenue were to settle down at the level of one of the lower months, our position would not be happy. Whether it will or not I cannot pretend to forecast—but allowance must certainly be made for the possibility. If the figures at the end of the year should prove that the Government has been unduly cautious, I think it will still be able to maintain that its policy at the beginning of the financial year 1947-48 was the correct policy, and I am quite sure that it will not find that any surplus that may arise from this happy state will be an embarrassment to the Government or the Colony on the ground that there are no pressing and vital needs to which it is proper to devote it.

Our planning must not stop at the balancing of our budget. We hope to finance our rehabilitation expenditure up to the end of March 1948 with the proceeds of the loan. That will entail capital expenditure of sixty million dollars this year and the charging of approximately forty million dollars to the loan in respect of special rehabilitation expenditure during the past year. But March 1948 will not see the end of our expenditure on rehabilitation work and large sums must be found for this purpose during the year 1948-49. Any borrowings which we are forced to make over and above the figure of a hundred million must be restricted to the lowest possible figure so that even if the present boom should continue and we are so fortunate as to come to the end of this financial year with a surplus, we shall indubitably need every cent of that surplus for absolutely essential expenditure. There are all sorts of commitments piling up for the future. We shall be forced to spend large sums over a period of years on extensions to our water supply. We must have a new airfield and we cannot expect one to be built unless we make a substantial contribution towards the cost. The Development Committee which is now sitting is about to make its recommendations, and they will certainly involve considerable expenditure from our own resources if they are to be proceeded with.

And then there is the past. Heavy commitments are still hanging over us on which negotiations with His Majesty's Government are in progress. The United Kingdom is said to be the most heavily taxed country in the world today and it is too much to expect that our representations in regard to these war payments will be sympathetically received unless we for our part make adequate and oven painful

efforts at least to pay our way fully in the future. The Council will appreciate that in addition to the reasons which have already been given for the passing of this Bill into law, there is the reason that this step will serve to convince His Majesty's Government that these efforts are in fact being made.

The Bill was read a First time.

**MERCANTILE MARINE ASSISTANCE FUND AMENDMENT
BILL, 1947.**

THE ATTORNEY GENERAL moved the First reading of a Bill intituled "An Ordinance to amend the Mercantile Marine Assistance Fund Ordinance, 1933." He said: This Ordinance provides for appropriations to be made to the Mercantile Marine Assistance Fund by the legislature of this Colony. The present Ordinance provides that such appropriations shall be made on the 1st January and re-appropriation, where all the money is not spent, shall take place on the 31st December. It is apparent that those dates do not coincide with the existing financial year. Accordingly, this Bill seeks to make adjustments in dates to make provision for appropriation and re-appropriation to coincide with the financial year. The opportunity has been taken to make an amendment which will replace the Treasurer by the Accountant General as the administrator of this Ordinance in conformity with the existing changes of title.

THE COLONIAL SECRETARY seconded, and the Bill was read a First time.

BRITISH CINEMATOGRAPH FILMS BILL, 1947.

THE ATTORNEY GENERAL moved the Second reading of a Bill intituled "An Ordinance to provide for the exhibition of British Cinematograph Films and to restrict the advance booking of cinematograph films."

THE COLONIAL SECRETARY seconded, and the Bill was read a Second time.

On the motion of the Attorney General, seconded by the Colonial Secretary, Council then went into Committee to consider the Bill clause by clause.

Upon Council resuming,

THE ATTORNEY GENERAL reported that the British Cinematograph Films Bill, 1947, had passed through Committee without amendment and moved that it be read a Third time and passed into law.

THE COLONIAL SECRETARY seconded, and the Bill was read a Third time and passed.

LANDLORD AND TENANT BILL, 1947.

THE ATTORNEY GENERAL moved the Second reading of a Bill intituled "An Ordinance to consolidate and amend the law relating to the restriction of rents." He said: I would take the opportunity to mention that it is my intention at the proper stage to move that this Bill be referred to the Standing Law Committee of this Council. My reason for so doing is that I feel that this Bill, on a subject which is notoriously a complex one, would do better to receive all possible attention in the drafting field so as to guard against difficulties in the future in the administration of the law and to avoid, in so far as possible, difficulty in litigation arising from such Bill when enacted as law. If this Council approves such motion it will of course not be objectionable if the Standing Law Committee should, in addition to giving consideration to this Bill in its drafting sphere, also give consideration to such criticism or other comment on the Bill as may have been brought to the notice of this Council.

THE COLONIAL SECRETARY seconded, and the Bill was read a Second time.

THE ATTORNEY GENERAL moved that the Bill be referred to the Standing Law Committee of the Council.

THE COLONIAL SECRETARY seconded, and the motion was carried.

ADJOURNMENT.

H.E. THE GOVERNOR. — That concludes our business, Honourable Members, and the Council now adjourns until Thursday, 1st May.