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11th May 2005



BY MAIL
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The Hon. Mr. Bernard Chan Chairman of LegCo Panel on Financial Affairs Legislative Council Building 8 Jackson Road Central



Hong Kong

Dear Mr Chan

Subject : **REVIEW OF THE INLAND REVENUE ORDINANCE (CAP112)**

We refer to our letter of 28 February 2005 regarding the captioned matter. Several of the Chamber members in our Financial Services Interest Group have considered the matter and we summarise their findings, in the Appendix. In particular the Appendix details those areas of the existing Inland Revenue Ordinance ("IRO") which our members view as urgently requiring updating and those areas of taxation which the IRO does not cover currently, but which it should cover if it were to be updated, to enable Hong Kong to continue to compete effectively in the international arena.

It is worth noting that the IRO is over 50 years old. It currently numbers 89 Articles and 12 schedules. Over the years, 21 Articles have been repealed and those Article numbers made redundant, whilst new Articles with lettering (i.e. Article 88A) have been inserted. So in total there are 183 operative Articles, in the IRO updated as to 28th May 2004, and which is available from the Government Stationery Office. It would be a simple matter at least to renumber the Articles. That could be the start. But we hope there is also a desire in the highest levels of Government to review all Articles, to reflect the actial practice of the Inland Revenue Department ("IRD") and to insert suitable new provisions.

Previously there was a body called the IRO Review Board whose job it was to keep the IRO under constant review. We would suggest that a similar body is recreated - possibly as a Statutory Body - with an able Chairman and with members drawn from a wide spectrum. For example the British Chamber would be happy to provide a suitable member of such a body, which could either now take on the job of reviewing the existing IRO, or, which could come into existence after such a review had been completed and a new IRO implemented.

Whilst we have seen a letter from the Commissioner of Inland Revenue advising that a committee called the Joint Liaison Committee for Taxation 'the JLCT' in practice performs the same function as the old IRO Review Board, in practice we do not think that is the case. To our understanding the JLCT does not have a written constitution or terms of reference - we understand that it is merely an ad hoc advisory body of tax specialists - and hence perhaps insufficiently

Where business gets done



representative to "police" a regular review of the IRO. In practice it has no powers or obligations to perform such a vital function.

If you require a meeting to go through these points with our members, we would be happy to arrange the same.

Yours sincerely,

Brigadier Christopher Hammerbeck CB Executive Director

Cc: Christopher Page – Chairman
David Dodwell – Vice Chairman Government Relations
Deborah Annells – Chair Financial Services Interest Group

Potential areas for reform of the existing Hong Kong Inland Revenue Ordinance

Clarify source of profits rules (Article 14).

(In particular the Inland Revenue Department ("IRD") in their Departmental Interpretation and Practice Note ("DIPN") No 21 on the Locality of Profits, amplify the statutory provisions as to what is Hong Kong source profit, in their view. Although they do not have statutory backing for this We believe there should now be a statutory definition of source. For example the IRD give 100% emphasis to the purchasing function taking place in Hong Kong in determining Hong Kong source profits of a trading company and we consider this to be an unfair emphasis in this day and age, as sourcing items is usually easier than the selling side.)

Clarify foreign employment rules (Article 8)

(In particular the IRD DIPN on Salaries Taxation causes lots of confusion as to what is a foreign employment. In many cases the IRD employ a "totality of facts" basis in determining what is a foreign employment, which does not even agree with their own DIPN, or the IRO. Again a statutory definition of foreign employment would be most useful, and give more certainly in this vexed area).

Relax ability to claim partnership losses (Article 22A)

Definitions of a capital gain/other items exempt from tax (Article 26A)

Clarify Transfer Pricing rules

Clarify treatment of Agents of overseas persons (Article 20A, and 20AA)

Clarify taxation of trusts

Clarify tax on the exercise of stock options(Article 9)

Salaries tax liabilities of employees seconded to work in PRC

Deduction for foreign taxes where no credit is available, is too limited

Application of the **Secan** case (i.e. when is expenditure deductible)(Article 16)

Exempt income from all corporate bonds

Clarify 50% exemption for manufacturing subcontracted to PRC (exemption not in the IRO but given in practice), and to which structures this will apply

Clarify/Relax deductibility restrictions on interest paid to overseas associates (article 16)

Decrease personal allowances, and simply calculation of Salaries Taxation liabilities (Part V) Very few understand the basis for the current calculations.

Increase deductions for home loan interest(Article 26E)

Improve Advance Tax Ruling processes (Article 88A)

Simplify Personal Assessment (Part VII)

Clarify Assessment process (Article 59)- whether the new Assess First Audit Later approach is legal. In particular the practice whereby nearly 6 years after the year of assessment is allowed to pass before protective assessments and additional assessments are raised by the IRD is regarded as a very cynical approach to Tax collection, as it is a much longer time limit for raising a late assessment than is allowed in most other countries. The time limit should be reduced to say 3 years.

Clarify calculations on Depreciation Allowances

Areas which should be dealt with in an updated Inland Revenue Ordinance

Consider introducing PAYE

Write off for more tourism industry related refurbishments

Introduce Polluter Pays taxes

Introduce Group Tax Loss Relief – our belief is this may increase tax collection in Hong Kong (whereas we understand the IRD believes the reverse is true). In practice many privately owned groups pay no tax in Hong Kong, but as different Assessors deal with each company no-one at the IRD has an overall picture of the Group's tax position in Hong Kong unless there is Field Audit.

Give Incentives for Global Trading Operations(ie benefit the Financial services sector)

Give tax incentives for high value add industries e.g. E-business, R & D, etc