Administration's Response to the Concerns and Questions raised at the Second Meeting (held on 20 May 2008) of the Bills Committee on Revenue Bill 2008

Paragraph 1(a)

1. We estimate that lowering the standard rate from 16% to 15% and the corporate profits tax rate from 17.5% to 16.5% would cost the Government $960 million and $4.4 billion a year respectively, on the assumption that the current tax base, individuals'/companies' income/profits level and all other relevant factors remain unchanged. We cannot forecast how these factors would change in the next 10 years.

Paragraph 1(b)

2. The following tables summarise the number and type of organisations/individuals that have during the Budget consultation directly indicated to us their support for or objection to the lowering of the standard rate and the corporate profits tax rate and their general reasons.

(i) Lowering of the standard rate

Support

Type of Organisations/ Individuals		No.	General Reasons
1.	Legislative Council members/political parties	1	• In view of the Government's strong fiscal position, the standard rate should be lowered to relieve taxpayers' burden. • It is a global trend to reduce direct tax rate and the proposal could enhance Hong Kong's competitiveness.
2.	Professional bodies	9	
3.	Chambers of commerce	4	
4.	Advisory/ statutory bodies	1	
5.	Members of the general public	12	
	TOTAL:	**27**	

Against

Type of Organisations/ Individuals		No.	General reasons
1.	Legislative Council members/political parties	6	• The proposal would not benefit the middle class and the low income group.
2.	Professional bodies	2	
3.	Chambers of commerce	0	
4.	Advisory/ statutory bodies	0	
5.	Members of the general public	6	
	TOTAL:	**14**	

(ii) Lowering of the corporate profits tax rate

Support

Type of Organisations/Individuals		No.	General Reasons
1.	Legislative Council members/political parties	1	• It is a global trend to cut direct tax rate. • Lowering the profits tax rate could enhance the tax competitiveness of Hong Kong, and attract Mainland and foreign investment.
2.	Professional bodies	10	
3.	Chambers of commerce	7	
4.	Advisory/ statutory bodies	0	
5.	Members of the general public	10	
	TOTAL:	**28**	

Against

Type of Organizations/ individuals/ sectors		No.	General Reasons
1.	Legislative Council members/political parties	6	• The existing profits tax rate is already quite low. Keeping the same tax rate would not have any adverse impact on Hong Kong's competitiveness. • Big companies have already benefited from the Hong Kong's economic growth and there is no need to reduce the profits tax rate.
2.	Professional bodies	1	
3.	Chambers of commerce	0	
4.	Advisory/ statutory bodies	1	
5.	Members of the general public	6	
	TOTAL:	**14**	

Paragraph 1(c)

3. The comparison table is at **Annex A**.

4. There are many factors affecting investors' choice of investment locations and taxation is no doubt a major one. According to Census and Statistics Department's annual Survey of Companies in Hong Kong Representing Parent Companies Located outside Hong Kong, a low and simple tax system has topped the list of key favourable factors affecting these companies' choice of Hong Kong as a location to set up their offices. It has been a global trend to reduce profits tax rate, and, apart from cutting the main tax rate, many economies are also offering various tax incentives for specific types of companies or economic activities. To maintain a simple and fair tax regime, Hong Kong rarely provides specific tax incentives, but keeps a low tax rate which benefits all sectors. Despite our overall lower tax rate, some people have argued that the effective tax rates for specific sectors in some neighbouring economies are in fact more favourable.

5. In any case, the increase of our corporate profits tax rate from 16% to 17.5% since 2003-04 is against the global trend. The proposed reduction of one percentage point would bring it closer to, although still slightly above, the 2002-03 level, and would help maintain Hong Kong's competitiveness. This is also in line with our proposals in the last and the current Budget to bring all major elements of salaries tax back to their 2002-03 levels.

Paragraph 1(d)

6. The total number of taxpayers that would benefit from the proposed lowering of standard rate is 144 000, among which 24 600 are unincorporated profits tax payers, 19 000 are salaries tax and personal assessment taxpayers and the rest are property tax payers.

Paragraph 1(e)(i)

7. The number of taxpaying corporations ranged from 55 300 to 74 200 in the years of assessment 2002-03 to 2006-07. A breakdown of their assessable profits is set out below –

Assessable Profits	No. of corporate profits tax payers in the year of assessment				
	2006/07	2005/06	2004/05	2003/04	2002/03
Over $50M	1,000	800	800	600	500
$30M to $50M	600	500	500	400	400
$20M to $30M	700	700	600	500	500
$10M to $20M	2,000	1,900	1,700	1,500	1,400
$7.5M to $10M	1,200	1,100	1,000	900	800
$5M to $7.5M	2,100	2,000	1,800	1,600	1,400
$3M to $5M	3,500	3,300	3,100	2,700	2,500
$2M to $3M	3,500	3,300	3,100	2,700	2,500
$1M to $2M	7,500	7,000	6,700	6,000	5,400
$1 to $1M	52,100	49,600	44,400	40,900	39,900
Total	74,200	70,200	63,700	57,800	55,300

8. We do not have the information on the number of staff employed by these corporations.

Paragraph 1(e)(ii)

9. The number of offices set up by non-local corporations in Hong Kong in the past five years is at **Annex B**.

Paragraph 1(e)(iii)

10. While we believe that the proposed reduction of corporate profits tax rate would further enhance Hong Kong's attractiveness to non-local corporations, we are unable to estimate the number of non-local corporations that would be attracted to invest in Hong Kong after the implementation of the proposal as there are other factors affecting a corporation's investment decisions.

Paragraph 2(a)

11. The amounts of charitable donations allowed for deduction under profits tax as well as salaries tax and tax under personal assessment for past five years are as follows-

Year of Assessment	Deduction ceiling	Charitable donations deducted	
	Percentage of assessable profits or income	Under profits tax	Under salaries tax and tax under personal assessment
		$million	$million
2002-03	10%	640	2,380
2003-04	25%	1,280	2,940
2004-05	25%	1,720	3,440
2005-06	25%	1,790	3,460
2006-07	25%	2,150	3,820

12. Raising the deduction ceiling for charitable donations should be able to encourage taxpayers to donate more. However, we are not able to estimate the amount of additional donations that would be made after the implementation of the proposal as there are other factors affecting an individual's or a company's donation decisions.

Paragraph 2(b)

13. To assess whether the tax-exempt status of approved institutions should be maintained, the Inland Revenue Department conducts regular reviews to ensure that the institutions' objects are exclusively charitable in nature and its activities are compatible with its objects. The Social Welfare Department has also since 1998 published a set of Guidance Notes on Internal Financial Controls for Charitable Fund-raising Activities for charitable organisations' reference. With the assistance of the Hong Kong Institute of Certified Public Accountants and the Independent Commission Against Corruption, the guidance notes include advice on basic controls to

ensure that income and expenditure generated from charitable fund-raising activities are properly documented and that such income is spent for the designated purpose. Besides, we understand that the Law Reform Commission has formed a sub-committee to review the law and regulatory framework relating to charities in Hong Kong.

Paragraph 3

14. We estimate that there are 16 000 businesses claiming the existing 60% profits tax deduction in respect of environment-friendly machinery. While the proposal would provide added incentive for businesses to use such machinery, we are not able to estimate the increase of such deduction claims after the implementation of the proposal as whether a business would use environment-friendly machinery is affected by other factors.

Paragraph 4

15. The Administration noted the suggestion.

Financial Services and the Treasury Bureau
May 2008

Annex A

Corporate Profits Tax Rates of Hong Kong and Neighbouring Economies

	Corporate Tax Rate				
	2008	**2007**	**2006**	**2005**	**2004**
Hong Kong	17.5%	17.5%	17.5%	17.5%	17.5%
Mainland China[1]	25%	33%	33%	33%	33%
Japan	30%	30%	30%	30%	30%
Macao	0% - 12%	0% - 12%	0% - 12%	0% - 12%	0% - 12%
Malaysia	26%	27%	28%	28%	28%
Singapore[2]	18%	20%	20%	20%	22%
South Korea[3]	14.3% - 27.5%	14.3% - 27.5%	14.3% - 27.5%	14.3% - 27.5%	16.5% - 29.75%
Taiwan[4]	0% - 25%	0% - 25%	0% - 25%	0% - 25%	0% - 25%
Thailand	30%	30%	30%	30%	30%

[1] Mainland China. Under the new Corporate Income Tax Law which has taken effect on 1 January 2008, a single income tax rate of 25% will apply to both domestic enterprises and foreign investment enterprises (FIEs). FIEs currently enjoying lower rates would be eligible for a 5-year transition period to move to the 25% tax rate.

[2] Singapore. Tax incentives in the form of tax exemption and reduced tax rates include:

(a) Tax exemption for 5 to 15 years for pioneer industries, i.e. companies manufacturing approved new and high technology products, etc.
(b) Reduced tax rate of 5% or 10% under the financial sector incentive scheme, for periods varying from 5, 7 to 10 years.
(c) Tax exemptions or reduced tax rates for qualifying income of approved venture companies, shipping companies, regional headquarters, etc.

[3] South Korea. Tax incentives in the form of tax exemption and reduced tax rates include:

(a) Foreign-invested companies that engage in certain qualified advanced technology and industry support services can apply for 100% exemption from corporation tax for 5 years and a 50% reduction for 2 years thereafter.

(b) Foreign-invested companies may also enjoy similar incentives for investment in designated investment zones.

[4] Taiwan. Tax incentives in the form of tax exemption and reduced tax rates include:

(a) Companies that invest in newly emerging, important and strategic industries may enjoy a 5-year exemption from enterprise income tax.

(b) Institutions that participate in large-scale public construction projects may be exempt from enterprise income tax for a maximum of 5 years.

Annex B

Regional Headquarters, Regional Offices and Local Offices of Non-Local Corporations in Hong Kong

	2007	2006	2005	2004	2003
Regional Headquarters	1 246	1 228	1 167	1 098	966
Regional Office	2 644	2 617	2 631	2 511	2 241
Local Office	2 550	2 509	2 474	2 334	2 207
Total	6 440	6 354	6 272	5 943	5 414

Definitions :

A **Regional Headquarters** is an office that has managerial control over offices in the region (i.e. Hong Kong plus one or more other places) on behalf of its parent company located outside Hong Kong.
A **Regional Office** is an office that coordinates offices and/or operations in the region (i.e. Hong Kong plus one or more other places) on behalf of its parent company located outside Hong Kong.
A **Local Office** is an office that only takes charge of the business in Hong Kong (but nowhere else) on behalf of its parent company located outside Hong Kong.

Source :

Reports on Annual Surveys of Companies in Hong Kong Representing Parent Companies Located outside Hong Kong (Census and Statistics Department)