

## **Legislative Council meeting on 7 July 2010**

### **Motion on**

### **“Enhancing the administration of tax policy in Hong Kong”**

### **Progress Report**

#### **PURPOSE**

At the Legislative Council meeting held on 7 July 2010, the motion moved by the Hon Paul CHAN mo-po, as amended by Hon Mrs Sophie LEUNG LAU Yau-fun, on “Enhancing the administration of tax policy in Hong Kong” was carried. Full text of the motion is at Annex.

2. This report briefs Members on the work of the Government relating to the major areas covered by the motion.

#### **WORK OF THE GOVERNMENT**

3. Hong Kong has all along maintained a simple tax regime with low tax rates and upheld the taxation principles of fairness and neutrality. To meet the needs of sustainable development of the community, the economy and the enterprises, and to enhance the competitiveness of Hong Kong, the Government has adopted an ongoing approach in reviewing the tax regime. This includes collecting views from various sectors of the community through different

consultation channels in the course of preparing the Budget each year, resulting in the introduction of a number of tax measures. For example, we have from time to time adjusted our salaries tax regime to cope with the social development trend, although generous allowances and deductions have already been provided under the regime. In the financial years of 2007-08 and 2008-09, we increased the amount of a number of allowances, including basic allowance, single parent allowance, child allowance and married person's allowance, and raised the deduction ceiling for approved charitable donations under profits tax, salaries tax and tax under personal assessment to 35% of assessable profits/income.

4. As regards supporting business development, all business operating expenses are now 100% deductible for taxation purposes. Besides, we have provided tax incentives in specific areas. For example, 100% tax deduction has been provided for capital expenditure on research and development, purchase of "patent rights" and "rights to know-how", purchase of eligible environmental protection facilities and environment-friendly vehicles. To promote the wider application of intellectual property by enterprises and the development of creative industries, the Financial Secretary proposed in the 2010-11 Budget to allow tax deduction for capital expenditure on "registered trade marks", "copyrights" and "registered designs". We are now formulating the implementation details and preparing proposals for the relevant legislative amendments with a view to putting in place the initiative early.

5. On taxation matters relating to the processing trade, we have explained to Members during the motion debate and at previous Council meetings that we have all along adopted a territorial source principle of taxation in assessing the

profits tax payable by enterprises (including Hong Kong enterprises engaging in “contract processing” or “import processing” in the Mainland). As the nature of business of Hong Kong enterprises engaging in “import processing” in the Mainland is no different from that of other enterprises engaging in trading activities, the Inland Revenue Department does not consider that the profits of those enterprises are partially derived in the Mainland. Hence, the 50:50 tax apportionment method under “contract processing” is not applicable to “import processing”. As regards the issue of providing depreciation allowances for machinery or plants used under the “import processing” arrangement, we are studying in collaboration with the Joint Liaison Committee on Taxation the feasibility of the proposal, including whether there are effective measures to plug the loopholes of tax avoidance. We will complete the study as soon as practicable.

6. Regarding the relaxation of the “183-day” rule stipulated in the Arrangement between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, we have explained to Members during the motion debate and at previous Council meetings that the rule not only complies with the international standard in model agreements for avoidance of double taxation, but also provides a fair and certain basis for allocating taxing rights between the Mainland and Hong Kong, thereby reducing greatly the possibility of Hong Kong residents working in the Mainland being taxed by the Mainland authorities. The Mainland authorities consider that there are no sufficient justifications for changing the “183-day” threshold at this stage. We would continue to keep in view social development and to explore the matter

with the Mainland authorities.

7. As regards enhancing Hong Kong's competitiveness, we cited during the motion debate a wide range of tax measures to promote the development of relevant industries and to consolidate Hong Kong's position as an international financial, commercial, tourist and logistics centre. These measures include waiving hotel accommodation tax, exempting the duties on wine, beer and all other alcoholic beverages except spirits, exempting offshore funds from profits tax, abolishing estate duty and extending the stamp duty concession in respect of the trading of exchange traded funds. Besides, to facilitate the development of a knowledge-based economy in Hong Kong, we have from the year of assessment 2007-08 onwards raised the maximum amount of tax deduction for self-education expenses to \$60,000 so as to encourage employees to seek continued self-advancement through learning.

8. Finally, there is a designated unit in the Treasury Branch of the Financial Services and the Treasury Bureau responsible for reviewing and formulating tax policies. We review the current tax regime from time to time, including studying various options for broadening the tax base, while adhering to the established taxation principles. In considering the introduction of tax measures that would be conducive to the overall economic development and be able to cope with the social development trend in Hong Kong, we would as ever consult the industries and the public extensively. At the same time, we will continue to participate actively in taxation conferences or seminars held by international organizations with a view to ensuring that Hong Kong's tax regime aligns with the international standards and requirements. On avoidance of double taxation, we are

committed to extending the network of comprehensive agreements for the avoidance of double taxation in order to consolidate Hong Kong's status as an international business and financial centre.

Financial Services and the Treasury Bureau

September 2010

**(Translation)**

**Motion on**

**“Enhancing the administration of tax policy in Hong Kong”**

**moved by Hon Paul CHAN Mo-po**

**at the Legislative Council meeting commencing on**

**Wednesday, 7 July 2010**

**Motion as amended by Hon Mrs Sophie LEUNG LAU Yau-fun**

That, whereas:

- (a) Hong Kong, through its membership of the Global Forum on Transparency and Exchange of Information for Tax Purposes under the Organization for Economic Co-operation and Development and the comprehensive agreements on avoidance of double taxation to be signed with many countries in the world, is increasingly involved in international taxation matters;
- (b) international organizations such as the Group of Twenty (‘G-20’) are proactively developing tax policies for implementation by the member countries and jurisdictions which are actively involved in the global economy and financial system, including Hong Kong;
- (c) with the increasingly closer economic and trade relationship between Hong Kong and the Guangdong Province under the Framework Agreement on Hong Kong/Guangdong Co-operation, the flow of

passengers, goods and information will become more frequent, and complementary tax initiatives must be introduced in Hong Kong to facilitate the upgrading and transformation of small and medium enterprises and to complement the development of industries with competitive edge and the smooth transformation of the Hong Kong economy;

- (d) Hong Kong must compete with other jurisdictions, which offer tax concessions, to attract external investors to establish their regional headquarters in Hong Kong;
- (e) tax initiatives can be an effective tool in addressing the problems of economic and social inequalities in Hong Kong; and
- (f) the tax base of Hong Kong remains very narrow, posing a risk of instability in public finance,

matters relating to the tax policy in Hong Kong have therefore become increasingly complex and important, yet the Administration has so far vested such matters primarily in the Inland Revenue Department ('IRD') but its function should be confined to the implementation of tax laws; if IRD is required to undertake in-depth and substantial studies on tax policy, it will encounter a conflict of roles as well as resources constraints; as such, this Council urges the Administration:

- (i) to adopt a proactive approach in responding to international agreements on tax initiatives and their requirements, including the tax policies and initiatives introduced by the G-20 and other multilateral international organizations;
- (ii) to critically review the existing taxation system with a view to identifying feasible initiatives to enhance the competitiveness of Hong Kong as a regional business centre;

- (iii) to examine afresh all the taxation policies involving cross-border trade and employment, including section 39E of the Inland Revenue Ordinance and assessment of profits tax for the processing trade, and to relax the existing 183-day standard under the Arrangement between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, so as to match the trend in the economic development of Hong Kong and Guangdong and the new life pattern of the 'one-hour living sphere';
- (iv) to study the use of tax initiatives as one of the means to address the problems of social and economic inequalities;
- (v) to study afresh the identification of reasonable and sound initiatives that can broaden the tax base of Hong Kong without undermining its competitiveness; and
- (vi) to establish a specialist tax policy unit within the government structure, to be staffed by local and international tax experts with the relevant professional knowledge, technical expertise and practical experience, to assist the Administration in undertaking the tasks in (i) to (v) above, so as to ensure effective formulation of future tax policy in Hong Kong.