# 立法會
# *Legislative Council*

LC Paper No. CB(1)790/13-14(02)

Ref : CB1/BC/3/13

**Bills Committee on Inland Revenue (Amendment) (No.3) Bill 2013**

**Background brief**

## Purpose

This paper provides background information on the Inland Revenue (Amendment) (No. 3) Bill 2013 ("the Bill"). It also summarizes the major views and suggestions raised by Members on issues relating to the proposals in the Bill.

## Proposed tax concession for captive insurers under the 2013-2014 Budget

2. Captive insurance is a form of self-insurance by companies. 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[1] 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. At present, there are two captive insurers in Hong Kong[2]. A number of regulatory concessions are currently offered to captive insurance companies, e.g. lower capital, solvency margin requirements and fees. The concessions currently provided to captive insurance companies and comparison with non-life insurance companies on regulatory requirements are given in **Appendix I**.

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1 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.

2 CNOOC Insurance Limited (authorized on 5 December 2000) and Sinopec Insurance Limited (authorized on 31 October 2013).

3. As one of the measures to foster cooperation between the Mainland and Hong Kong, the State Council of the Central People's Government promulgated in June 2012 the policy to encourage Mainland enterprises to form captive insurers in Hong Kong to enhance their risk management. In the 2013-2014 Budget, the Financial Secretary proposed to reduce the profits tax on the offshore insurance business of captive insurance companies so that they would enjoy the same tax concessions under the Inland Revenue Ordinance (Cap. 112) ("IRO") as those currently applicable to reinsurance companies (i.e. one-half of the normal tax rate of 16.5% for corporations). According to the Administration, it has consulted the Insurance Advisory Committee on the tax concession proposal in August 2013 and obtained its support.

**Increasing the deduction ceiling for contributions to recognized retirement schemes**

4. Section 16AA of IRO provides for the deduction of mandatory contribution by self-employed persons ("SEPs") for the purpose of calculating their tax payable under profits tax. Section 26G of IRO provides for the deduction of contribution to recognized occupational retirement schemes and mandatory contribution to the Mandatory Provident Fund ("MPF") Schemes by employees for the purposes of calculating tax payable under salaries tax or tax under personal assessment. The maximum amount of allowable deduction under section 16AA or 26G of IRO for each year of assessment is prescribed in Schedule 3B to IRO. It is currently set at $15,000 (i.e. $25,000 x 5% x 12 months).

5. On commencement of the Mandatory Provident Fund Schemes Ordinance (Amendment of Schedule 3) Notice 2013 on 1 June 2014[3], the maximum relevant income ("Max RI") under the Mandatory Provident Fund Schemes Ordinance (Cap. 485) ("MPFSO") will be increased from $25,000 to $30,000 per month. Following this, the Administration proposes to increase the deduction ceiling for contributions[4] to recognized retirement schemes from $15,000 to $17,500[5] for the 2014/15 year of assessment, and $18,000[6] from the 2015/16 year of assessment onwards.

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3 The Legislative Council ("LegCo") has set up a subcommittee to study the Mandatory Provident Fund Schemes Ordinance (Amendment of Schedule 3) Notice 2013. At the meeting of 17 July 2013, the LegCo passed a resolution to approve the Schedule 3 Notice to enable the implementation of the new maximum relevant income of $30,000 on I June 2014.

4 Contributions include: (a) mandatory contributions by a SEP under MPFSO; (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 MPFSO.

5 $25,000 x 5% x 2 months + $30,000 x 5% x 10 months

6 $30,000 x 5% x 12 months

**The Bill**

6. The Bill, for the purpose of implementing the two proposals in paragraphs 3 and 5 above, was published in the Gazette on 27 December 2013 and received First Reading in LegCo on 8 January 2014. The main provisions of the Bill are as follows –

(a) *Clause 3*: provides that the profits tax concession for qualifying captive insurers applies to the year of assessment commencing on 1 April 2013 and to all subsequent years of assessment;

(b) *Clause 4*: amends section 14B of IRO to allow a corporation's assessable profits that are derived from the business of insurance of offshore risks as a captive insurer to be chargeable to profits tax at one-half of the normal rate;

(c) *Clause 6*: amends section 23A IRO to provide for the formula for ascertaining a captive insurer's assessable profits that are derived from the business of insurance of offshore risks;

(d) *Clause 7*: amends Schedule 3B to IRO to raise the maximum amount deductible from assessment income for the following contributions –

(i) mandatory contributions paid by any SEP under MPFSO; and

(ii) certain contributions paid by any person to a recognized retirement scheme as an employee; and

(e) *Clauses 8 and 9*: adds a new Schedule 30 to IRO to provide for the transitional arrangements relating to the holding over payment of provisional salaries tax and provisional profits tax, on the ground of the taxpayer's entitlement to the rise in deduction ceiling for contributions to recognized retirement schemes, for the years of assessment 2014/15 and 2015/16.

7. The Bill, if passed, would come into operation on the day on which it is published in the Gazette.

8. At the House Committee meeting held on 10 January 2014, Members agreed to form a bills committee to study the Bill.

**Major views and concerns expressed by Members**

9. Members have raised matters relating to the development of captive insurance and the proposed profits tax concessions during the session on financial services of the special meeting of the Finance Committee held on 8 April 2013 for the examination of the Estimates of Expenditure 2013-2014. The Administration consulted the Panel on Financial Affairs on the two proposals under the Bill at the meeting on 4 November 2013. Panel members were generally in support of the two proposals. The major views and concerns raised by Members at the above meetings are summarized in the ensuing paragraphs.

<u>Proposed tax concession for captive insurers</u>

*Attracting more companies to set up captive insurers in Hong Kong*

10. Noting that some jurisdictions in Asia had offered more tax concessions for captive insurers, including Singapore which had exempted captive insurers from all profits tax, some Members considered that the proposed tax concessions might not be competitive enough in attracting foreign captive insurers to establish in Hong Kong. There was a suggestion that the Administration should consider offering more incentives, for example, by exempting the captive insurers from all profits tax in their first two years of operation in Hong Kong. The Administration advised that the Government had granted other regulatory concessions for promoting captive insurance business, e.g. lowering their capital and solvency margin requirements, exempting them from the requirement of maintaining assets in Hong Kong, etc. The tax concessions proposed in the 2013-2014 Budget would act as a further impetus in attracting captive insurers to domicile in Hong Kong. The Administration would review the measure after one or two years of implementation, and consider whether further concessions would be necessary with due regard to the impact on tax revenue.

11. On Members' enquiries about the major considerations of captive insurers to set up business in Hong Kong besides tax concessions, the Administration responded that the sound legal system, robust regulatory regime and availability of a wide range of professional services were major incentives for setting up business in Hong Kong. Moreover, the proximity of Hong Kong to major Mainland cities and the policy support from the Central People's Government were also instrumental in making Hong Kong an attractive domicile for captive insurers. Given that the concept of captive insurance was still novel to many enterprises in Asia, the Government would accord priority to working with the industry in increasing market awareness and promoting utilization of captive insurance. As regards the benefits for the local job

market, the Administration advised that it might not be necessary for captive insurers to employ a large workforce of its own as they could outsource captive insurance management services to insurance broker firms. Nevertheless, with the establishment of more captive insurers in Hong Kong, it was envisaged that the pool of local professionals of related business (e.g. reinsurance, legal and actuarial services) would expand in future.

12. In providing incentives for enterprises to set up captive insurance companies in Hong Kong, there was a view from Members that the Administration should balance the interests between large foreign insurance companies and small and medium-sized local insurance companies. The Administration advised that both foreign and local insurance companies, regardless of their size, had all along been competing on a level playing field in Hong Kong. Encouraging foreign enterprises to set up their captive insurance companies in Hong Kong would have minimal impact on the interests of small and medium-sized local insurance companies because captive insurance companies exclusively underwrote the risks of their parent companies, group companies or other affiliated companies. Those risks were mostly outside Hong Kong which were not the target business of small and medium-sized local insurance companies.

13. Upon request by Members, the Administration had provided information on the insurance sector, including the number of captive insurance companies and professional reinsurance companies authorized in Hong Kong in recent years, the revenues from profits tax generated from these companies, and the percentage of contribution of insurance business to the Gross Domestic Product of Hong Kong. The information is in **Appendix II**.

*Avoidance of double taxation*

14. Members have enquired about the measures to avoid double taxation on Mainland-based companies setting up captive insurance business in Hong Kong. The Administration advised that 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 ("the Arrangement"), the profits of a Mainland enterprise carrying on business through a permanent establishment in Hong Kong would be subject to Hong Kong tax but the Mainland enterprise would be entitled to a tax credit in the Mainland. As Hong Kong adopted the territorial basis of taxation, the profits of a Hong Kong enterprise derived from a permanent establishment in the Mainland would not normally be subject to profits tax in Hong Kong, and hence there would be no double taxation. The Arrangement would help avoid levying double taxation in respect of profits tax of captive insurers set up by Mainland companies in Hong Kong.

Proposed increase in the deduction ceiling for contributions to recognized retirement schemes

15. In the light of the ageing population in Hong Kong, a Member suggested that the Administration should consider granting more tax concessions to encourage employees and SEP to increase the voluntary contributions to their retirement schemes so as to enhance their personal savings for better retirement protection. The Member considered that such tax concessions would be particularly useful for MPF schemes, as under such schemes the employers' mandatory contributions would be used to offset the severance payment or the long service payment which would reduce the savings for MPF scheme members. The Administration was urged to consider the suggestion in the context of the 2014 Policy Address and the 2014-2015 Budget.

**Relevant papers**

16. A list of the relevant papers on the LegCo website is in **Appendix III**.

Council Business Division 1
Legislative Council Secretariat
27 January 2014

**Appendix I**

**Concessions currently granted by the Government to captive insurance companies and comparison with non-life insurance companies on regulatory requirements**

| **Item** | **Captive Insurer** | **Non-life Insurance Company** |
|---|---|---|
| Minimum Capital Requirement | HK$2 million | HK$10 million |
| Minimum Solvency Margin | The greatest of:<br>a. 5% of the premium income; or<br>b. 5% of the claims outstanding; or<br>c. HK$2 million | The greatest of:<br>a. generally 20% of the premium<br>b. generally 20%of the claims outstanding; or<br>c. HK$10 million |
| Requirement for Assets in Hong Kong | Exempted | To maintain assets in Hong Kong of an amount not less than 80% of its Hong Kong net liabilities plus solvency margin |
| Valuation Regulation | Assets and liabilities to be valued on the basis of Generally Accepted Accounting Principles | Assets and liabilities to be valued according to the Insurance Companies (General Business) (Valuation) Regulation |
| Authorization and Annual Fee | HK$22,600 | HK$227,300 |

(*Source*: Extract from the Administration's reply to a written question raised by Hon LEUNG Kwok-hung during the examination of Estimates of Expenditure 2013-2014 (Reply Serial No. FSTB(FS)086))

**Appendix II**

Examination of Estimates of Expenditure 2013-14

Reply Serial No.

**FSTB(FS)081**

**CONTROLLING OFFICER'S REPLY TO INITIAL WRITTEN QUESTION**

Question Serial No.

5471

Head: 148 – Government Secretariat : Financial Services and the Treasury Bureau (Financial Services Branch)

Subhead (No. & title):

Programme: Financial Services

Controlling Officer: Permanent Secretary for Financial Services and the Treasury (Financial Services)

Director of Bureau: Secretary for Financial Services and the Treasury

Question:

It is stated in paragraph 51 of the Budget Speech that the Government proposes to reduce the profits tax on the offshore insurance business of captive insurance companies. Please provide the following information:

(a) the amount of resources to be allocated by the Administration to implement the above work in the coming year (2013-14);

(b) for the past five years (from 2008-09 to 2012-13), the respective revenues from profits tax on offshore insurance business of captive insurance companies and reinsurance companies, and the respective percentages of the profits tax to the total amount of profits tax per year;

(c) for the past five years, the change in the number of enterprises engaging in offshore insurance business of captive insurance companies and reinsurance business per year;

(d) for the past five years, the change in the employment size of the offshore insurance business of captive insurance companies and reinsurance business;

(e) for the past five years, the change in the total employment of the insurance business per year; and

(f) for the past five years, the percentage of contribution of insurance business to the Gross Domestic Product of Hong Kong per year.

Asked by: Hon. LEE Wai-king, Starry

Reply:

(a) In 2013 -14, the work will be jointly pursued by the Financial Services and the Treasury Bureau and Office of the Commissioner of Insurance. The expenses will be absorbed from within our existing resources.

(b) In the 2007/08 – 2011/12 assessment years, the revenues from profits tax of captive insurance companies and professional reinsurance companies are as follows:

| Assessment year | Revenues from profits tax of captive insurance companies[Note1] and professional reinsurance companies [Note2] ($ million) | Percentage of total profits tax |
|---|---|---|
| 2011/12* | 171 | 0.16% |

| | | |
|---|---|---|
| 2010/11 | 167 | 0.17% |
| 2009/10 | 111 | 0.13% |
| 2008/09 | 142 | 0.18% |
| 2007/08 | 168 | 0.17% |

* As at 28.3.2013.

Note 1: Currently, there are no tax concessions for the assessable profits derived from the offshore business of captive insurance companies. They are chargeable to tax at the same rate as local insurance business.

Note 2: According to Section 14B of the Inland Revenue Ordinance (Cap. 112), the assessable profits derived from the offshore business of professional reinsurance companies could be chargeable to tax at one-half of the rate.

(c) From 2008 to 2012, the numbers of captive insurance companies and professional reinsurance companies authorised in Hong Kong are as follows:

| | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|
| Captive Insurance Companies | 2 | 2 | 2 | 2 | 1 |
| Professional Reinsurance Companies | 21 | 19 | 19 | 19 | 19 |

(d) The Census & Statistics Department does not have the relevant figures.

(e) According to the three existing self-regulatory organisations of the insurance sector, the numbers of registered individual insurance agents and insurance brokers[Note3] from 2008 to 2012 are as follows:

| | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|
| Insurance agents and insurance brokers | 38,077 | 39,472 | 40,922 | 43,407 | 46,406 |

Note 3: The figures exclude registered insurance technical representatives working in institutions the principal business of which is not insurance, such as banks and travels agents.

(f) From 2007 to 2011, contribution of insurance business (measured in terms of value added) to the Gross Domestic Product of Hong Kong is as follows:

| | 2007 | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|---|
| Percentage share of value added in GDP [Note4] | 3.2% | 3.0% | 2.8% | 3.1% | 2.9% |

Note 4: Nominal GDP at basic prices.

Name in block letters: Miss AU King-chi

Post Title: Permanent Secretary for Financial Services and the Treasury (Financial Services)

Date: 5.4.2013

**Appendix III**

## List of relevant papers

| Date | Event | Paper/Minutes of meeting |
|---|---|---|
| April 2013 | Special meeting of the Finance Committee for examination of Estimates of Expenditure 2013-2014 | Written questions raised by members on issues relating to captive insurance business<br>(Reply Serial Nos: FSTB(FS)022, 055, 081 and 086) |
| July 2013 | Report of the Subcommittee on Mandatory Provident Fund Schemes Ordinance (Amendment of Schedule 2) Notice 2013 and Mandatory Provident Fund Schemes Ordinance (Amendment of Schedule 3) Notice 2013 ("the Notices") | Report<br>(LC Paper No. CB(1)1478/12-13) |
| 17 July 2013 | Council meeting | Hansard<br>(Relevant proceedings of the proposed resolutions moved by the Administration in relation to the Notices in pages 249-305) |
| 4 November 2013 | Meeting of the Panel on Financial Affairs | Discussion paper<br>(LC Paper No. CB(1)155/13-14(02))<br><br>Minutes (paragraphs 8 to 17)<br>(LC Paper No. CB(1)626/13-14) |

| Date | Event | Paper/Minutes of meeting |
|---|---|---|
| 8 January 2014 | Introduction of the Inland Revenue (Amendment) (No. 3) Bill 2013 into the Legislative Council | The Bill<br><br>Legislative Council Brief on Inland Revenue (Amendment) (No. 3) Bill 2013<br>(L/M(19) in G6/90/4C(2011) Pt.5)<br><br>Legal Service Division report on the Bill<br>(LC Paper No. LS22/13-14) |