LC Paper No. CB(1)1405/16-17(06)

JOINT LIAISON COMMITTEE ON TAXATION

CONSTITUENT MEMBERS: **THE AMERICAN CHAMBER OF COMMERCE**
THE HONG KONG GENERAL CHAMBER OF COMMERCE
HONG KONG INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS
THE INTERNATIONAL FISCAL ASSOCIATION - HONG KONG BRANCH
THE LAW SOCIETY OF HONG KONG
THE TAXATION INSTITUTE OF HONG KONG
FEDERATION OF HONG KONG INDUSTRIES
THE HONG KONG ASSOCIATION OF BANKS
CAPITAL MARKETS TAX COMMITTEE OF ASIA
14th Floor, Hutchison House, Central, Hong Kong.
Telephone: (852) 2846 1816
Fax: (852) 2845 0476

4 September 2017

The Honourable Mr. Kenneth Leung
Chairman
Bills Committee on Inland Revenue (Amendment) (No.4) Bill 2017
Legislative Council Secretariat
Hong Kong

Dear Mr. Leung,

Submission on the Inland Revenue (Amendment) (No.4) Bill 2017

We write to make a submission concerning the Bill, in response to the request made on behalf of the Clerk to the Bills Committee dated 4 August 2017.

We have only one point to make, and that is in regards to section 20AJ(3), which reads (in English) as follows:

> "If an open-ended fund company is not exempt from the payment of tax chargeable under this Part in a year of assessment, then despite section 26(a), the consideration or remuneration that a person received, in the form of a dividend from the company, for providing any services in Hong Kong, directly or indirectly, to the company is chargeable to tax under this Part."

We understand the policy behind this provision is to impose tax on dividends which represent disguised remuneration. Although we do not seek to challenge this policy, we would ask you to note that this proposal causes a problem where the company that pays the dividend is subject to Hong Kong tax, which is the situation that section 20AJ(3) targets.

The problem is this. Remuneration that is subject to tax in the hands of the recipient is (generally) deductible to the payor. This avoids double taxation of the same income. However, dividends are not deductible, because they represent a distribution of profits that have been made, not a distribution of an amount that is incurred for the purpose of producing taxable income (which is the criterion for deducibility set out in section 16(1) of the Inland Revenue Ordinance). The proposed section 20AJ(3) is similar in concept to taxing a person on his or her salary but without allowing the employer to deduct the salary payment.

To avoid double taxation, we therefore suggest it is necessary to add a provision to entitle the payor company to deduct the amount of any dividend which will be taxed under the new section 20AJ(3).

The net result of our proposal would be that no tax is payable, because the taxable income of the recipient would be off-set by the deduction given to the company. This is the same tax treatment that applies to all forms of remuneration paid by a taxpaying entity (except in the unusual case where the recipient is based outside Hong Kong and is not subject to Hong Kong tax, but that is not the situation being addressed here).

Alternatively, we suggest a simpler solution, which is to delete section 20AJ(3) altogether. In this case, the recipient would not be taxed, and the company would not claim a deduction. The end result would be the same (ie, no net tax would be payable whichever solution is adopted). In fact, this simpler alternative is preferable for two reasons.

First, it would not violate the established principle in Hong Kong that dividends are not taxed, and therefore would not create any conceptual change to Hong Kong's tax system.

Secondly, it would actually ensure that more tax revenue is collected overall. This is because, under the current system, the payment of a dividend is completely tax neutral (because there is no deduction and no taxable income). However, by taxing the dividend and (out of fairness) allowing a deduction, the deduction would cost the Revenue 16.5%, whereas the recipient, if an individual subject to Profits Tax, will be taxed at most 15%. Indeed, if the individual elects for Personal Assessment (which we envisage would happen in most cases), the tax rate payable by him or her could be far less than 15%. This creates a tax leakage which is undesirable.

Assuming the deduction approach is preferred, it is possible that a company will earn both taxable and non-taxable income, and that the amount of the dividend will exceed the company's taxable income. To deal with this situation, the company's deduction could be limited to the amount of its taxable income, thereby avoiding the company generating a tax loss which could be carried forward and offset against its taxable income in future years. Alternatively, the deduction could be scaled down on a proportionate basis, so that only the proportion allocable to the company's taxable income is permitted deductibility.

We offer no other comment on the Bill, and hope that members of the Bills Committee will consider our submission favourably. We do not propose to make an oral submission to the Committee.

If you wish any further explanation or clarification, please feel free to call me at 98378049.

Yours sincerely,

Michael Olesnicky
Chairman
For and on behalf of
The Joint Liaison Committee on Taxation