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Paper for the House Committee meeting on 16 November 2018

**Report of the Subcommittee on Tax Reserve Certificates (Rate of Interest)
(Consolidation) (Amendment) Notice 2018**

Purpose

This paper reports on the deliberations of the Subcommittee on Tax Reserve Certificates (Rate of Interest) (Consolidation) (Amendment) Notice 2018 ("the Subcommittee").

Background

2. Rule 7(2)(h) of the Tax Reserve Certificates (Fourth Series) Rules (Cap. 289A) ("the Rules") provides that for tax reserve certificates ("TRCs")¹ issued on or after 11 April 1980, the rate of interest on TRCs ("TRC rate") is such rate as may be fixed by the Financial Secretary² from time to time and is in force at the date of issue thereof. Under rule 7(2A) of the Rules, notice of the TRC rate so fixed shall be published in the Gazette.

3. According to the Administration, the TRC rate is, under the current established mechanism, reviewed on a monthly basis based on the average prevailing rate of interest for the six-month time deposit below HK\$100,000 offered by the three

¹ Tax Reserve Certificates ("TRCs") are issued by the Commissioner of Inland Revenue ("CIR"). As explained by the Administration, there are two types of TRCs, namely (a) ordinary TRCs which are purchased by taxpayers on their own volition who wish to prepare for tax payment in future; and (b) conditional TRCs which are required by CIR for taxpayers who have objected to or appealed against their tax assessments, and have been granted a "conditional stand-over order" in order to cover the total amount or part of the tax in dispute.

² Under section 3 of the Interpretation and General Clauses Ordinance (Cap. 1), "Financial Secretary" is defined to mean the Financial Secretary of the Hong Kong Special Administrative Region and the Secretary for Financial Services and the Treasury.

note-issuing banks.³

The Tax Reserve Certificates (Rate of Interest) (Consolidation) (Amendment) Notice 2018

4. The Tax Reserve Certificates (Rate of Interest) (Consolidation) (Amendment) Notice 2018 (L.N. 147 of 2018) ("the Notice") is made by the Secretary for Financial Services and the Treasury under rule 7(2)(h) of the Rules to amend the Schedule to the Tax Reserve Certificates (Rate of Interest) (Consolidation) Notice (Cap. 289B) to provide that the rate of interest payable on TRCs issued on or after 6 August 2018 shall be 0.0767% per annum.⁴ According to the Administration, the above rate of interest payable on TRCs is fixed by reference to the average prevailing interest rate for the six-month time deposit below HK\$100,000 offered by the three note-issuing banks as at 30 July 2018.

5. The Notice was gazetted on 3 August 2018 and tabled at the Council meeting of 10 October 2018 for negative vetting.

The Subcommittee

6. At the House Committee meeting on 12 October 2018, Members agreed to form a subcommittee to study the Notice. The membership list of the Subcommittee is in **Appendix**.

7. With the passage of a motion moved by Hon Kenneth LEUNG at the Council meeting of 31 October 2018 to extend the scrutiny period of the Notice, the deadline for amending the Notice has been extended to the Council meeting of 28 November 2018.

8. Under the chairmanship of Hon Kenneth LEUNG, the Subcommittee held one meeting on 6 November 2018 with the Administration to examine the Notice. The Subcommittee has received one submission from an organization⁵ on the Notice.

³ The three note-issuing banks in Hong Kong are The Hongkong and Shanghai Banking Corporation Limited, the Bank of China (Hong Kong) Limited and the Standard Chartered Bank (Hong Kong) Limited.

⁴ The rate of interest was last fixed at 0.0433% per annum in January 2010 pursuant to the Tax Reserve Certificates (Rate of Interest) (No. 6) Notice 2009 (L.N. 264 of 2009).

⁵ Please see LC Paper No. CB(1)156/18-19(01) for details of the submission from The Joint Liaison Committee on Taxation (English version only).

Deliberations of the Subcommittee

9. While raising no objection to the Notice which seeks to adjust the TRC rate as a routine exercise under the current established mechanism, members have expressed concerns over the mechanism for adjustment of the TRC rate and the difficulties faced by some Hong Kong enterprises, in particular small and medium enterprises ("SMEs"), arising from their tax disputes with the Inland Revenue Department ("IRD"). The deliberations of the Subcommittee are summarized in the ensuing paragraphs.

Tax assessment and the mechanism for adjustment of the rate of interest on tax reserves certificates

10. The Subcommittee notes that under section 71(1) of the Inland Revenue Ordinance (Cap. 112) ("IRO"), tax charged under the provisions of IRO shall be paid in the manner directed in the notice of assessment on or before a date specified in such notice. Taxpayers may lodge objections or appeals should they disagree with their tax assessment. However, pursuant to section 71(2) of IRO, tax shall be paid notwithstanding any notice of objection or appeal, unless the Commissioner of Inland Revenue ("CIR") orders that payment of tax or any part thereof be held over pending the result of such objection or appeal.

11. In cases of tax disputes, CIR will take into account the circumstances of individual cases in considering whether to allow the taxpayers to hold over payment of the tax involved. If it is obvious to CIR that the objection or appeal should be allowed, an "unconditional stand-over order" will be granted to the taxpayer pending revision of the tax assessment. If CIR considers that the objection or appeal has some merits but that the balance of probability, based on the facts available at the date of the objection or appeal, does not weigh definitely in favour of the taxpayer, CIR will, in accordance with section 71(2) of IRO, issue a "conditional stand-over order" requiring the taxpayer to purchase TRCs in the amount of the tax held over, or to furnish CIR with a banker's undertaking.

12. According to section 71 of IRO, if taxpayers have purchased TRCs in pursuance of "conditional stand-over orders" in relation to objection or appeal cases, interest will be computed at floating rates over the tenure of the certificate and will be paid on these TRCs to the extent to which the TRCs are eventually not required to settle the tax held over, i.e. the parts in which the taxpayers' objection or appeal are successful. If the objections or appeals are subsequently withdrawn or determined against the taxpayers (wholly or in part), the taxpayers may tender TRCs or a part of TRCs in payment of the tax held over and found payable. No interest is payable upon any TRCs or part thereof so tendered.

13. The Subcommittee further notes that the mechanism for adjustment of the TRC rate was last modified in January 1999 to implement the arrangement that the review on the TRC rate be made on a monthly basis, instead of on a tri-monthly basis, so as to ensure that changes in interest rate offered by the note-issuing banks are reflected in TRCs in a timely manner.

14. Given that the last modification was made about two decades ago, Hon CHUNG Kwok-pan is concerned that the existing adjustment mechanism of the TRC rate may be outdated and is unable to keep pace with the changes in the market trend over time. He is of the view that while some enterprises would have to purchase TRCs of huge amounts as required by CIR in pursuance of "conditional stand-over orders" in relation to their objection or appeal cases, the rate of interest payable on TRCs which are eventually not required to settle the tax held over (i.e. the parts in which the taxpayers' objections or appeals are successful) is extremely low. To keep in line with the market practice that a higher interest rate is normally fixed for the time deposit of a large sum of money vis-à-vis a small sum, Mr CHUNG has urged the Administration to conduct a comprehensive review on the mechanism for adjustment of the TRC rate. In this regard, he suggests that the possibility of fixing a separate rate of interest payable on TRCs of huge amounts be explored, with reference to the average prevailing interest rate offered by banks for time deposits of more significant amounts (e.g. amounts in the region of one to two million Hong Kong dollars).

15. The Administration has advised that the TRC rate has been kept at a low level in the last decade as a result of the global low interest rate environment. In view of the recent interest rate hikes, the Notice was published on 3 August 2018 to effect an adjustment to the TRC rate starting from 6 August 2018 (from 0.0433% per annum to 0.0767% per annum). Another Legal Notice was published in the Gazette on 2 November 2018 (L.N. 211 of 2018) to effect a further increase to the TRC rate starting from 5 November 2018 (from 0.0767% per annum to 0.25 % per annum). As the information on the interest rate offered by banks for time deposits of a large sum of money is not transparent in the market, it is practically difficult to make reference to the relevant interest rates when determining the rate of interest payable on TRCs of huge amounts. That said, the Administration takes note of the views expressed by members on the existing mechanism for adjustment of the TRC rate and will consider whether changes should be made.

Difficulties faced by enterprises arising from tax disputes

Impact on cash flow of enterprises

16. The Subcommittee notes that for most of the objection or appeal cases in respect of tax assessments with "conditional stand-over orders" issued, the purchase of TRCs in the amount of the tax held over will be required. On this, Hon CHUNG

Kwok-pan has pointed out that requiring the enterprises concerned, in particular SMEs, to purchase TRCs before their tax disputes are settled will exert tremendous pressure on their cash flow and impose heavy financial and psychological burdens on them, given that the processing of some objection or appeal cases may continue for years, and some enterprises are required to purchase TRCs of huge amounts.

17. The Administration has advised that as the tax administration of the Government, IRD is mainly responsible for the assessment and collection of taxes. It has to safeguard government revenue when performing its role. All along, IRD handles tax matters in a fair, impartial and professional manner and assists taxpayers to understand and fulfill their tax obligations. According to IRD, of the 120 508 objection cases being processed at the beginning of 2017-2018 and received during the year, taxpayers in only about 1 600 cases are required by CIR to purchase TRCs in pursuance of "conditional stand-over orders".⁶ A significant proportion of the objection cases received arise from estimated assessments and most of such cases are settled promptly by reference to the returns subsequently received. Many of the other types of objections are also settled by agreement between the taxpayers and the assessors concerned. The Administration has further advised that if taxpayers encounter financial difficulties in purchasing TRCs in the amount of tax held over in pursuance of "conditional stand-over orders", they may approach IRD to resolve the problem under the established mechanism, which includes application to IRD for payment of tax by installments. CIR may also accept a taxpayer furnishing a banker's undertaking in lieu of purchase of TRC if the taxpayer could demonstrate that the taxpayer could not afford to purchase TRC due to financial difficulties.

Judgment debt rate

18. The Subcommittee notes that if the taxpayers are granted "unconditional stand-over orders", or "conditional stand-over orders" requiring the provision of banker's undertakings, issued by CIR for their objection or appeal cases, and the taxpayers eventually withdraw the objections or appeals or the objections or appeals are determined against the taxpayers, the taxpayers would be required to pay interest on so much of the tax or any part held over which, upon the withdrawal or final determination of the objections or appeals, is found payable. The rate of interest payable is the judgment debt rate (the current rate is 8% per annum) prescribed in section 50 of the District Court Ordinance (Cap. 336).

19. Given that upon the lodging of an objection or appeal against a tax assessment by an enterprise, interest shall be payable on the tax held over at the judgment debt rate of 8% per annum if the enterprise concerned fails the case eventually, whereas interest on TRC it has purchased is payable at the rate of just 0.0767% per annum (i.e. the rate as provided in the Notice) if the case is successful, Hon CHUNG Kwok-pan

⁶ Please see LC Paper No. CB(1)172/18-19(02) for details of the objection statistics.

is concerned about the substantial disparity between the two interest rates, and considers that the said practice is extremely unfair to the enterprise concerned.

20. The Administration has explained that the relevant provisions under IRO (as detailed in paragraph 18) aim to protect tax revenue by preventing taxpayers from abusing the objection mechanism for the purpose of deferring tax payment. An enterprise should take into account the relevant cost of interests in deciding whether to pursue an objection or appeal, which is a commercial decision of the enterprise concerned. If taxpayers disagree with the CIR's decisions to require them to purchase TRCs or to furnish banker's undertakings in pursuance of the "conditional stand-over orders", they may apply for judicial review regarding such decision in the High Court.

Recommendation

21. The Subcommittee has no objection to the Notice and will not propose any amendments thereto.

Advice sought

22. Members are invited to note the deliberations of the Subcommittee.

**Subcommittee on Tax Reserve Certificates (Rate of Interest)
(Consolidation) (Amendment) Notice 2018**

Membership List

Chairman	Hon Kenneth LEUNG
Members	Hon CHUNG Kwok-pan Hon SHIU Ka-fai (Total : 3 members)
Clerk	Mr Desmond LAM
Legal Adviser	Ms Wendy KAN