

## JOINT LIAISON COMMITTEE ON TAXATION

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CAPITAL MARKETS TAX COMMITTEE OF ASIA  
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5 November 2018

Mr Kenneth Leung  
Room 918, Legislative Council Complex  
1 Legislative Council Road  
Central  
Hong Kong

Dear Kenneth,

### **Proposal to increase interest rate payable on tax reserve certificates**

We understand that government is proposing to increase the interest rate payable on tax reserve certificates (TRCs) and that the legislative Council has convened a panel to review this proposal. For the purpose of assisting the panel's deliberations, the JLCT would like to offer some comments about this proposal.

As you know, the IRD generally requires taxpayers who are contesting a tax assessment to purchase TRCs as a condition for being granted a holdover. Effectively, this is not a true deferral of tax – it effectively means that the taxpayer is paying the tax immediately in the sense that it makes funds available to government immediately. The only benefit from purchasing TRCs instead of formally paying the disputed tax is to entitle the taxpayer to receive interest upon repayment if the taxpayer ultimately prevails in its tax dispute.

By contrast, if a taxpayer is granted an unconditional holdover of the tax in dispute, it will not be required to make any immediate payment. However, it will be required to pay interest at the court judgment debt rate if it is ultimately unsuccessful in its tax appeal. The judgment debt rate payable by taxpayers is currently 8% pa, which is markedly higher than the rate payable by the IRD on redemptions of TRCs.

It appears to us that this mis-match between the rates payable by the taxpayer and the IRD is unjustified. The concept should be that interest is designed to provide for commercial restitution being provided to the party who is out-of-pocket, by the party who benefits from the use of those funds. The considerations for both taxpayers and the IRD are the same. This in turn suggests that the interest rate payable by both the IRD and taxpayers should be more or less the same. (That said, we do not object to a slightly higher rate to be payable by taxpayers than by the IRD – but the current differential is in our view vastly excessive.)

We have heard it suggested that taxpayers should pay a higher interest rate to reflect a penalty element for incorrectly objecting to a tax assessment and thereby delaying their payment of tax. With respect

however, that suggestion overlooks the fairness point that such a penalty element should apply equally where the IRD has incorrectly made an assessment and therefore required a taxpayer to make a payment that turns out to be unjustified. That said, we query whether it is appropriate to talk in terms of a penalty in such contexts where there is a bona fide dispute between the taxpayer and the IRD. Nevertheless, if the intention is to compensate the party who is out-of-pocket at more than a commercial rate, then the excess should be similar for both taxpayers and the IRD (subject to our comment above that we accept that the rate payable by taxpayers should be slightly higher than the rate payable by the IRD).

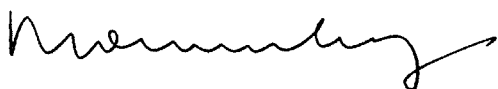
In our view, the recommendation to reduce the spread between the interest rates payable by both parties is based on notions of fairness and equity. Forcing the taxpayer to pay tax in dispute, and to receive only paltry interest if it ultimately prevails, creates a hardship for many taxpayers, especially if they are required to borrow the funds from their bankers. Such disputes can stretch over many years which of course exacerbates the problem, during which taxpayers are effectively being forced to fund the government if their claim is successful. In addition, entitling the IRD to demand payment of disputed tax and to pay a low uncommercial rate upon any repayment removes incentive for the IRD to deal with tax disputes in a timely manner. Any concerns in these regard would be met by requiring the IRD to pay a similar interest rate to that which taxpayers are required to pay, and for such rates to be fixed on a commercial basis. We therefor urge that the rate payable on TRCs be increased significantly, and the rate payable by taxpayers be reduced significantly.

On a side point, we would also suggest consideration be given to abolishing TRCs generally. The process of paying tax could be simplified by requiring taxpayers to pay their tax bill outright, and for interest to be paid by the IRD if it turns out that such payment was excessive. Likewise, in cases in which the IRD sees fit to grant a deferral of tax, the taxpayer could simply be required to pay interest on any delayed payment. Such a change would of course require legislative amendment.

We would be very happy to meet with you in order to discuss these matters further. My mobile number is [REDACTED].

We hope you find these comments helpful. Please do not hesitate to contact us if you have further questions.

Best regards,



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