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香港華人會計師公會
The Society of Chinese Accountants & Auditors

(在香港註冊成立的有限公司)
(Incorporated in Hong Kong as a company limited by guarantee)

21 January 2009

Mr. Tsang Chun-wah, John, J.P.
Financial Secretary
Hong Kong Special Administrative Region
of The People's Republic of China
5/F., Central Government Offices,
Main Wing,
Lower Albert Road,
Hong Kong

Dear Sir,

Re: 2009/10 BUDGET SUBMISSION

In 2008, the financial tsunami has significantly reversed the world's economy and Hong Kong is of no exception. The tightening of the bank finance, significant drop in overseas orders and the enactment of the new labour law in PRC etc. have further exerted great financial pressure on the Hong Kong entrepreneurs particularly those operating manufacturing production in PRC. All these factors created much impact to the economy of Hong Kong.

We would like to share with you some suggestions for your consideration. We believe that they can help to sustain our economic development while granting relief to citizens encouraging and assisting them to overcome the downturn of economy.

1. PROFITS TAX AND SALARIES TAX RATE

Though the government may expect to record a deficit budget, yet the taxpayers have and will continue to face global economic downturn. We suggest to maintain the corporate and unincorporated profits tax rates and standard tax rate at the present level.



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2. PERSONAL ALLOWANCES

As a measure to reduce the tax burden and to benefit more taxpayers from the middle income group who form the pillar of Hong Kong's economy, we suggest:

- ♦ to widen all the tax band width from HK\$40,000 to HK\$45,000
- ♦ to reduce the respective progressive tax rates by 1% as follows:

Existing rate	2%	7%	12%	17%
Suggested rate	1%	6%	11%	16%

3. NEW ALLOWANCE FOR SALARIED EMPLOYEES

"I will get my job done" – this is a mission put forward by the Chief Executive in his election campaign and has been perceived as a positive attitude. Unfortunately, salaried employees are at present penalized for doing their job better because of the stringent deduction provisions in the Inland Revenue Ordinance ("IRO").

For salaries tax purposes, section 12 of the IRO provides that deductions may be claimed for "all outgoings and expenses, other than expenses of a domestic or private nature and capital expenditure, *wholly, exclusively and necessarily* incurred in the production of the assessable income". The words emphasized have been described by the Court as being "*notoriously rigid, narrow and restricted in their operation*".

In a Board of Review Decision handed down on 28 November 2006 (D61/06, *Board of Review Decision, Volume 21, 3rd Supplement*), the Board rejected a secondary school teacher's claim as deductible expenses for purchases of books and CDs for (i) reference and self study to improve her own teaching quality and professional abilities and (ii) lending to her students to improve reading interests and language abilities. The following comments in Chinese of the Board are noteworthy:



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6. 從納稅人展示的課堂教材及聆聽席前的陳述，本委員會相信她確實應用參考書籍光碟於課堂教學上，亦確信她的學生有直接受益，而對她孜孜不倦，全心全意全力投入教導學生的專業精神，予以肯定及支持。

7. 無奈，根據現行稅法，本委員會必須裁定納稅人的有關開支不符合稅例第 12 條規定，不能被扣減。除非政府另行立法，如設定扣減限額，為購置教學用教材的老師們提供稅務減免，以鼓勵老師們多運用課本以外的參考書籍及教材，否則，按現行稅法，老師們祇可透過學校購置或利用圖書館的設施，否則有關的開支是很難獲得稅務減免的。

We understand that the reason for providing stringent requirement in salaries tax cases is that one would expect an employer to pay any expenses incurred by an employee in discharging his duties. In reality, salaried employees always pay expenses out of their own pocket in order to “get the job done” or to do the job better.

We recommend a new expense deduction allowance for salaried employees to meet expenses not otherwise deductible under section 12 of the IRO. The allowance may be similar in nature to ‘Self-education Expenses’ and may likewise be set at \$60,000 initially.

We submit that this new measure will directly benefit taxpayers that aimed to prepare better to meet the challenges faced. In the long run, consideration should be given to remove the stringent requirements in section 12 having regard to the development of similar legislation in other countries. The Joint Liaison Committee in Taxation (“JLCT”) may be a suitable venue to deliberate the matter.

4. OBJECTIONS AND APPEALS

Loss Cases

It is the practice of the IRD to issue a statement of loss if a taxpayer incurred loss in a year of assessment. It has been established by the court that the statement of



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loss is not an assessment and has been further confirmed that the 6-year “time bar” provision under section 60 of the IRO does not apply. As section 51C of the IRO requires taxpayers to keep records for 7 years only, taxpayers always find it difficult to discharge the onus of proof if IRD seeks to disallow losses beyond 6 years. Accounting personnel may have left the companies and/or important evidences such as documents from third parties, including banks and other companies, may have been destroyed due to the long time frame. Section 60 is intended to finalise a taxpayer’s tax affairs and it is therefore not fair to keep the loss years open for an indefinite period.

We recommend that loss statement should be given the status of ‘assessment’ so that the objection and time limitation provisions are applicable.

Interest on Held Over

On receiving a valid objection to a tax assessment, the CIR may hold over the tax in dispute unconditionally or conditionally upon purchases of a Tax Reserve Certificate (“TRC”). In the latter case, a taxpayer will receive refund for the amount of TRC plus interest at TRC interest rate, which is currently 0.3667% p.a., if the result of the objection is in his favour. On the other hand, if tax is held over unconditionally and the taxpayer’s objection fails, the taxpayer has to pay the tax held over plus interest at judgment interest rate, which is currently 8.192% p.a. We do not see any reason for the disparity. It is certainly not the legislature’s intention to deter taxpayer from exercising his right of objection by imposing a heavy interest.

We recommend that the interest on tax held over unconditionally should be calculated by reference to the TRC interest rate instead of the judgment interest rate.

5. DENIAL OF DEPRECIATION ALLOWANCE UNDER SECTION 39E (1)(b)(i) OF INLAND REVENUE ORDINANCE “IRO”) IN RESPECT OF PLANT AND MACHINERY “USED WHOLLY OR PRINCIPALLY OUTSIDE HONG KONG”



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As stated in Departmental Interpretation and Practice Notes No. 15 (Revised) Part B - Leasing arrangements (Section 39E) that "Section 39E was enacted to limit the opportunities for tax deferral or avoidance through the sale and leaseback, offshore equipment leasing and leveraged leasing arrangements. In broad terms section 39E operates to deny to a lessor (owner) initial and annual allowances ("depreciation allowances") in respect of any machinery or plant owned by him where a person holds rights as lessee under a lease of the machinery or plant ... " and under "(b) the machinery or plant, other than a ship or aircraft or any part thereof, is while the lease is in force: (i) used wholly or principally outside Hong Kong by a person other than the lessor;...." This section was enacted in 1998. At the time the legislation was drafted, one would not be able to see the changes of economy and law legislation in PRC. Thus, Section 39E of IRO has not catered to the current economic and operation mode in PRC.

Over these past few years, taxpayers who operate manufacturing concerns in PRC face challenges over the need to change in their mode of operation, from the initial "Contract Processing (來料加工)" to "Import Processing (進料加工)". The PRC Government has established policies to encourage or require Hong Kong enterprises conducting in the form of "Import Processing (進料加工)" to incorporate as PRC companies/subsidiaries. Basically the enterprises in Hong Kong continue to support the operations in PRC as previously. The only change was only in the legal structure of the manufacturing concern in PRC.

To fulfill the requirements to inject the registered capital commitment, some Hong Kong enterprises inject capital in the form of fixed assets, e.g. machinery and equipment, into the manufacturing concern in PRC. It is fully accepted by taxpayers that these machinery and equipment so injected are not entitled to claim depreciation allowances in Hong Kong.

For Hong Kong enterprises which have already fulfilled the requirement to inject the registered capital into the company in PRC, they may still have to purchase machinery, moulds and equipment for production use in PRC. These machinery, moulds and equipment do not need to be included as injection of capital and would not need to be recorded in the books of the company in PRC.



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Presently, depreciation allowances on these machinery and equipment in Hong Kong are not allowed due to the application of Section 39E of the Inland Revenue Ordinance. These substantially increased the tax burden of the taxpayer which would otherwise be allowable if the machinery and equipment are used in Hong Kong.

When the machinery and equipment are shipped into PRC, the Customs in PRC require the application to be in the name of the factory in PRC no matter whether they are the assets of the factory or not. However, under the present applications, these are not treated as assets of the Hong Kong enterprise and the depreciation allowance for the said assets are disallowed.

The Hong Kong SAR government has emphasized the need to help SMEs and other enterprises to sustain their continuation in operation, such as granting of undertaking to financial institutions to finance SMEs, but the current interpretation of the IRO results in SMEs not being able to obtain depreciation allowance on these machinery and equipment which are owned by them but located in their factories in China to facilitate production only. Surely, this is not the original intention in the legislation stage. We therefore recommend that the legislation be changed to cater for the current situation.

The definition of "lease" under Section 2 of IRO defines "lease", in relation to any machinery or plant, includes (a) any arrangement under which a right to use the machinery or plant is granted by the owner of the machinery or plant to another person; ... This has also been interpreted as "lease" by including the placing of machinery and equipment in the factory in China though no lease is signed.

We recommend amending the IRO to enable depreciation allowance being allowed in these genuine cases where the machinery and equipment are actually owned by the taxpayer but placed in the factory in China for production use and never been used to fulfill the requirements of registered capital commitment injection. This would help SMEs and enterprises in Hong Kong so that they will not be taxed unfairly.



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6. BUSINESS REGISTRATION FEE

We suggest continuing the good practice in last year's budget to waive the business registration fee for one more year for 2009/10 in order to benefit all companies.

7. CHARITABLE DONATION

In order to further encourage companies and individuals to take up more social responsibilities, we suggest raising the limit of approved charitable donation from 35% to 50% of assessable profit/income and allows the balance of deductible donation to be carried forward to next year if the company/individual does not have sufficient income to cover the deductible donation. We also suggest to allow charitable donation deductions according to the actual amount of donation subject to a maximum amount of HK\$100,000 in the donation year for loss case and carried forward the balance of the charitable donation eligible for deduction to subsequent years. This measure could on one hand encourage citizens to contribute to the society and help the charitable organization and quasi-government bodies to maintain a constant stream of donation income and partially release the financial burden on the Government in additional support in the education and social welfare sectors.

8. GROUP LOSS RELIEF AND LOSS CARRY-BACK

Owing to different legal, commercial, risk management or economic reasons, in many circumstances businesses operate under a group of companies. This is essential if not inevitable in today's business world for SMEs or international conglomerates. However, unlike many other countries such as Singapore and Japan, group loss relief or similar system is still not yet available in Hong Kong. The experience of Singapore in the group loss relief system proved that most of the concerns brought up by the Hong Kong Government regarding this, like loss



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of revenue, complexity of the tax law, etc, may not be as serious as expected or could have ways to deal with, for instance, by adopting the group loss transfer system. Nonetheless, without such tax relief, Hong Kong will place itself at a global tax and economic disadvantage. So we suggest the government to reconsider adopting the group loss relief in our tax system so that Hong Kong can compete in a level playing field with other countries as an incentive to attract foreign investors.

9. TAX ON UNREALISED GAINS

Following the adoption of HKAS 39, “securities held for trading” are valued based on the “fair value” method meaning that unrealized gain or loss will be taken up in the income statement at the financial year end. . In addition, DIPN No.1 (revised) stipulates that the “fair value” method will be followed by IRD for the purpose of profit tax assessment. It is obviously unfair to the taxpayer, especially in situation like last year. A company might probably record a huge unrealized gain on securities in 2007 and a huge unrealized loss in 2008. Throughout the period, the taxpayer may have only held the “securities held for trading” without deriving any cash inflow or outflow.

Under the present situation, the taxpayer has to pay tax on unrealised gains for 2007 and then claim back the investment loss later on if the company has assessable profits in the future to cover the loss. Therefore we suggest providing a two-year loss carry back period to the taxpayers. Another alternative is only to tax the gain upon realization of the securities. This could also alleviate the problem and unnecessary financial burden on taxpayers.

10. ASIAN PROFESSIONAL HUB & MEMBERSHIP SUBSCRIPTION FEES

Many professionals like lawyers, accountants and doctors, are often required to join professional associations to sustain their professional qualifications and attend “Continuous Professional Development (CPD)” courses to maintain their



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qualifications and technical capability. However, they often enjoy the least benefit from the government but comparatively contributing a significant tax payment to the government. We recommend that Hong Kong be developed as an Asian Professional Hub so that our world class professionals can service the clients throughout the region. In addition, it is suggested that, membership subscription fees deduction for professionals be extended to more than one professional body to cater for the modern business environment and to allow deduction for Mandatory CPD expenses as raised in "Item 3 New Allowance for Salaried Employees" above.

11. MEDICAL INSURANCE PREMIUM DEDUCTION

Every year the government has to budget almost 15% of the overall expenditure for the "Health" sector. This is expected to increase in the future as a result of the aging population in Hong Kong. In order to encourage the public to shoulder part of the responsibility of the private medical burden, we suggest to provide an incentive by way of Medical Insurance Premium Deduction to a maximum annual amount of HK\$30,000.

We hope that you will give due consideration to our suggestions stated above in preparing your drafting of the Budget, and would be happy to discuss with you in detail on any of the above suggestions. Should you require further clarifications, please feel free to contact me.

Yours faithfully,

Chua Suk Lin, Ivy
President