



創於1913年  
Founded in 1913

# 香港華人會計師公會

## The Society of Chinese Accountants & Auditors

(在香港註冊成立之有限公司)

(Incorporated in Hong Kong as a company limited by guarantee)

3 February 2016

Mr. TSANG Chun Wah, John, GBM, JP  
The Financial Secretary  
Government of the Hong Kong Special Administrative Region  
The People's Republic of China

Dear Sir,

### **Budget Submission**

The Society of Chinese Accountants and Auditors was formed in 1913 and incorporated in 1948. The CPA firms of which our members are partners, directors or managers, service a significant majority of businesses in Hong Kong, and also companies investing into or through Hong Kong. Our members directly and regularly communicate with clients, their directors and employees and consequentially understand their needs and concerns.

In the coming year, Hong Kong and the whole world will be facing potential economic turmoil. It is with this in mind that we herewith submit our suggestions for your consideration.

### **CARING FOR THE INDIVIDUALS**

#### **1. WIDENING THE TAX BANDS AND ADJUSTING THE MAXIMUM RATE**

Under the present Salaries Tax regime, progressive rate is levied on assessable income after the deduction of allowances. With the increasing cost of living and the implementation of the minimum wages scheme, the level of wages earned by taxpayers has increased. It is important that the tax rate for adjusted especially for the middle class salary earners who do not benefit from any other subsidies from the Government.

#### **RECOMMENDATIONS –**

- Raising the tax band from the present level of \$40,000 to \$50,000 to relieve the tax burden of the sandwich class taxpayers
- In addition, in order to avoid confusion between the maximum progressive rate (17%) and the standard rate (15%), it is suggested to reduce the maximum progressive rate from 17% to 15%. This proposal should eliminate Personal Assessment disadvantage cases and save the administrative cost in inviting the taxpayer to withdraw Personal Assessment.



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### 2. ALLOWANCES

#### A. INCREASING THE BASIC ALLOWANCE, MARRIED PERSON'S ALLOWANCE AND CHILD ALLOWANCE FOR SALARIES TAX AND PERSONAL ASSESSMENT

Based on the following information, one will notice that the increase in Basic/Married Allowances in the last few years fell short of inflation:

<u>Year of Assessment</u>	<u>Inflation Increase Rate</u>	<u>Basic Allowance</u>		<u>Child Allowance</u>	
		<u>Amount</u>	<u>Increase</u>	<u>Amount</u>	<u>Increase</u>
2010/11	4.5%	108,000	0	50,000	0
2011/12	5.3%	108,000	0	60,000	20%
2012/13	4.1%	120,000	11%	63,000	5%
2013/14	4.3%	120,000	0	70,000	11%
2014/15	4.9%	120,000	0	70,000	0
2015/16	2.5%	120,000	0	100,000	43%

Although the Government reduced salaries tax and tax under personal assessment for 2014/15 by 75%, subject to a ceiling of \$20,000, the increase in overall allowances granted still fell short of inflation.

We understand that there is not necessarily a correlation between tax allowances and inflation. However, we submit that taxpayers should not be asked to shoulder an unnecessary burden when there is fiscal surplus. There is therefore a need to adjust Basic/Married Allowance to cope with inflation.

#### RECOMMENDATIONS –

- Increasing the Basic Allowance to \$140,000 per year and the Married Person's Allowance to HK\$280,000 per year;
- In addition, we suggest that Dependent Brother/Sister Allowance should likewise be adjusted.



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### **B. RELAXING THE ENTITLEMENT TO ADDITIONAL DEPENDENT PARENT AND DEPENDANT GRANDPARENT ALLOWANCES**

At present, Additional Dependent Parent and Dependent Grandparent Allowances can only be claimed by taxpayers living together with their parents or grandparents. We fully appreciate that this special requirement aims at encouraging the younger generation to take care of their parents and/or grandparents. However, with the high property prices, the floor area affordable by the younger generation gets smaller and smaller. Forcing the younger and the elder generations to live together in small apartments may create tensions between the generations and therefore lead to other social problems. There is a Chinese saying, "It's fine to meet each other but difficult to live together" ("相見好, 同住難"). Many taxpayers choose to rent or purchase separate quarters for their parents/grandparents.

#### **RECOMMENDATIONS –**

- Extending Additional Dependent Parent and Dependent Grandparent Allowances to taxpayers who have provided living quarters for their parents and/or grandparents, either by renting or purchasing separate properties.

### **C. INTRODUCING "WORKING MOTHER ALLOWANCE" & FLEXIBLE WORKPLACE**

To mitigate the consequences of an ageing population and shrinking labour force, the Government is seeking methods to increase working population. We propose to introduce "Working Mother Allowance" to encourage women to remain in or rejoin the workforce.

Most female homemakers who gave up their career to devote to their families possess high education level and precious working experience that can be valuable manpower resources. Some grassroots female homemakers who shoulder family burdens lack the incentive to work and to seek subsidies from the Government. With the introduction of "Working Mother Allowance", employers can attract talents and alleviate manpower shortages and Government's financial burden on public expenditure such as Comprehensive Social Security Assistance (CSSA) can be lightened.

#### **RECOMMENDATIONS –**

- Introducing "Working Mother Allowance" for qualifying working mothers;
- Providing support for families with both parents working, such as childcare service and flexible workplace arrangements.



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### D. INTRODUCING “DISABLED PERSON’S ALLOWANCE” FOR DISABLED SALARIED PERSONS

While taxpayer is given additional allowances for maintaining disabled dependents, he is not given similar allowance if he himself is a disabled person. To encourage disabled persons to rejoin the workforce and to enhance their self-esteem, we propose to introduce a new “Disabled Person’s Allowance”.

#### RECOMMENDATIONS –

- Introducing a new “Disabled Person’s Allowance” for disabled taxpayers. Disabled person who is employed and salaried in Hong Kong can be granted such allowance.

### E. PROVIDING RELIEF FOR HIGH MEDICAL COSTS

With the ageing population in Hong Kong, it is important that those who can afford to seek private medical help be encouraged to shoulder part of the responsibilities by going to private hospitals instead of drawing on public resources by going to public hospitals.

To relieve the financial burden to taxpayers who have responsibility for seriously ill dependent relatives, we propose to introduce “Seriously ill Dependent’s Allowance”.

#### RECOMMENDATIONS –

- Introducing a new “Seriously ill Dependent’s Allowance”. A patient whose illness is of such severity that there is cause for immediate concern but there is no imminent danger to life can be granted such allowance;
- Providing deduction up to a maximum of \$30,000 per annum for Medical Insurance Premium or medical expenses;



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### 3. RELIEF MEASURES ON HOUSING

#### INCREASING THE TIME LIMIT AND THE MAXIMUM AMOUNT OF HOME LOAN INTEREST

As a result of the sky-rocketing property prices in recent years, taxpayers can hardly finance the purchase of properties with 10-year mortgage terms. Although property prices are expected to decline, the present property prices still pose difficulties for young couples. To assist them on their home purchases and to relieve the burden of middle income earners on home mortgage loan, the home loan interest deduction should be reviewed.

#### RECOMMENDATIONS –

- Extending the entitlement of home loan interest deduction to 25 years.

### 4. ALIMONY ALLOWANCE

According to a 2015 report from the Census and Statistics Department, the number of divorce cases in Hong Kong has tripled from 1991 to 2013. Given the increasing trend, the Government should consider the following recommendations.

#### RECOMMENDATIONS –

- Providing an alimony allowance such that the spouse maintaining the other could obtain a full tax deduction for their alimony payment.

### 5. EXPENSES ON CHILDREN

Middle income earners faces heavy burden on pre-nursery education which became almost the pre-requisite to admit to most of the kindergartens. In addition to the recent measures suggested by the Government, we have the following suggestion to relieve part of the burdens:

#### RECOMMENDATIONS –

- Allowing the tax deduction on the pre-nursery education expenses (including the uniform costs, book costs and miscellaneous costs charged by the recognised educational institutions). The recognised educational institutions may include non-profit making educational institutions. We further suggest that deduction shall be claimed on an actual incurred basis.



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### CARING FOR THE EMPLOYERS

#### 6. DEDUCTION OF RESEARCH AND DEVELOPMENT EXPENDITURE

In enhancing the development of Hong Kong into an innovative, efficient, clean and more competitive city, it is time to consider more tax incentive to be granted to the Research and development (R&D) done in Hong Kong so as to encourage enterprises to join hands with the government in fulfilling such policy blueprint. While other neighboring jurisdictions including Mainland China and Singapore are offering more than 100% deductions on the cost of the R&D, the deduction claim in Hong Kong remains unchanged for years which might have cut down our competitive advantage.

##### RECOMMENDATIONS –

- Increasing deduction of up to 200% of the cost of the Research and Development Projects conducted in Hong Kong.

#### 7. CHARITABLE DONATIONS

Donations to charitable institutions may partially release the financial burden on the Government to additional demands from the education and social welfare sectors during years of economic downturns. The present tax deduction provision however discourages regular donors to continue to contribute to these social responsibilities in a loss year or when profit for the year decreased drastically in any year.

##### RECOMMENDATIONS –

- Hiking the percentage threshold of the donation to 50% of the assessable profit of the taxpayer for approved charitable donations;
- Allowing deductible donations to be able to be carried forward in the year when the taxpayer incurred losses. In the circumstances, the allowable donations may be limited to the donations made by the taxpayer in the past 5 years.
- Exempting the Buyer's Stamp Duty of purchasing properties by charitable organizations.



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### **8. GROUP LOSS RELIEF AND LOSS CARRY-BACK**

There have been public outcries for group loss relief and loss carry-back for many years. We believe that it is time for the Government to respond to the public's requests.

Our neighboring areas, such as Singapore and Japan, have adopted group loss relief or similar system. Hong Kong has placed itself in a global tax and economic disadvantage in comparison with our competitors.

Taxpayers are obliged to pay tax on profit made during a year. However, loss results in subsequent years cannot be carried backward and will be forfeited upon cessation of business. In order to assist small and medium enterprises to survive through the current unstable economic conditions and to provide a more favourable tax environment to attract potential investors, we suggest that the Government should consider granting tax relief for carrying back losses.

#### **RECOMMENDATIONS –**

- Introducing new legislation allowing group loss transfer;
- Allowing current year loss to be carried back for setting off the profits of the last two years.

### **9. BEPS IMPACT**

BEPS No. 6 - Final Report on Action 6 - "Preventing the Granting of Treaty Benefits in Inappropriate Circumstances" was released on 5 October 2015. One of the recommendations is to impose a Limitation-on-benefits (LOB) rule on Double Taxation Agreements (DTAs) which has with the following features:

- I. It recognizes that Governments, publicly-traded companies / financial institutions and some entities generally widely held are unlikely to be established for treaty shopping purposes;
- II. Individuals are generally entitled to DTA benefits if meeting the DTA's "resident" requirements;
- III. An "active conduct of a business" test has been introduced for companies that are not widely held.

On the "active conduct of business" test, it may likely have a significant impact due to its potentially wide coverage. Under paragraph 47 of the Commentary to LOB rule, it states:



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*"An entity generally will be considered to be engaged in the active conduct of a business only if persons through whom the entity is acting (such as officers or employees of a company) conduct substantial managerial and operational activities."*

Nevertheless, headquarters operations are not regarded as an active conduct of business according to paragraph 48 of the Commentary:

*"Since a headquarters operation is in the business of managing investments, a company that functions solely as a headquarters company will not be considered to be engaged in the active conduct of a business...."*

To Hong Kong, the impact could be far-reaching. The era of a single-purpose "Hong Kong shell company" for holding investments that is still eligible for treaty benefits may soon come to pass given this LOB rule. This may affect Hong Kong's position as an international gateway for inbound and outbound investments vis-a-vis China and other countries in Asia Pacific.

In addition, BEPS may have an impact on the newly enacted offshore PE fund exemption legislation.

Following the enactment of the Inland Revenue (Amendment) (No.2) Ordinance 2015 on 16 July 2015, the Hong Kong offshore fund exemption has now been extended to certain private equity (PE) transactions that do not have too many Hong Kong ties or connections.

Under this tax exemption regime, a PE could conduct only "specified transactions," including transactions in securities in a portfolio company or a special purpose vehicle (SPV), where the SPV would have to be established solely for the purpose of holding (directly or indirectly) or administering one or more portfolio companies, and could not carry on any other business in Hong Kong. Given such restriction of SPV's activities, SPV could only carry out headquarters function, which, as mentioned above, cannot be considered as an "active conduct of a business" for purpose of the LOB rule. Accordingly, if the DTA between Hong Kong (of which SPV is a tax resident) and a treaty country (of which a portfolio company is a tax resident) contains the newly recommended LOB rule, the SPV, by definition, will not be able to enjoy any of the DTA benefits, including preferential withholding tax rates on dividends and capital gains.

### RECOMMENDATIONS –

- Take appropriate measures to address the above concerns.





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### 10. MAINTAINING TAX NEUTRALITY, EQUITY AND SIMPLICITY

Neutrality, equity and simplicity are general tax principles emphasized by Adam Smith in his well-known book: "The Wealth of Nation". They have been adopted by tax administrations around the world in formulating their policy. It is our submission that there are provisions in the Inland Revenue Ordinance which are not consistent with the neutrality and equity principles.

S. 16 of the Inland Revenue Ordinance ("IRO") provides that "*In ascertaining the profits in respect of which a person is chargeable to tax under this Part for any year of assessment there shall be deducted all outgoings and expenses to the extent to which they are incurred during the basis period for that year of assessment by such person in the production of profits in respect of which he is chargeable to tax.....*" (emphasis added)

However, the provisions for outgoings and expenses deductions for taxpayers that pay Property Tax and Salaries Tax are different.

#### Property Tax

Whilst section 16 of the IRO allows taxpayers subject to Profits Tax to deduct ALL outgoings and expenses incurred in the production of assessable profits, property owners are only allowed to deduct 20% of the assessable value in computing the net assessable value subject to Property Tax.

With the introduction of the Mandatory Building Inspection Scheme, Mandatory Window Inspection Scheme, etc., an allowance of 20% for repairs and outgoings may no longer be able to cover the expenses incurred in producing the rental income. As a result there were taxpayers appealing to the Board of Review seeking for deduction of the actual cost incurred or to report their rental income under Profits Tax.

#### Salaries Tax

Taxpayers chargeable to Salaries Tax are also facing similar unfair treatment.

S.12(1)(a) of the IRO stated that "*(1) in ascertaining the net assessable income of a person for any year of assessment, there shall be deducted from the assessable income of that person-*

*(a) 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;*"

It is well-known that the words "wholly, exclusively and necessarily" are notoriously rigid,



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narrow and restricted. With these words in the present tax legislation, the chance of a salaried taxpayer claiming deductions is nearly zero (*Lomax v Newton (1953) 34 TC 558, 561-562*). In *D61/06 (IRBRD Volume 21, 3<sup>rd</sup> supplement)*, a teacher was unfairly disallowed expenses for purchase of books; in *CIR v Franco Tong Sui Lun, HCIA 2/2006*, a securities dealer was disallowed bad debts that were deducted from his commission income, etc. The Court and the Board of Review agreed that the expenditure incurred by the taxpayers would have enhanced the quality of the taxpayers' work, were reasonable and deductible if the taxpayers were subject to Profits Tax. Nevertheless, the Court/Board decided that the expenditure were not "legally deductible" under Salaries Tax.

In *D102/03 (IRBRD Volume 18, 3<sup>rd</sup> Supplement)*, the Board of Review had paid regard to the inherent unfairness in the contrasting rules governing Salaries Tax and Profits Tax deductions. In other words, the present legislation in this respect is not neutral and inequitable.

### RECOMMENDATIONS –

- Establishing a **Tax Policy Steering Committee** (or, "special unit") under the Financial Services and Treasury Bureau to conduct a thorough review of the deduction provisions for Property Tax and Salaries Tax with a view to maintaining neutrality, simplicity and equality
- Increasing the allowance for repairs and outgoings in section 5(1A) of the IRO from 20% to 30% pending the result of the review.



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### 11. REVIEWING THE EFFICIENCY OF FIELD AUDIT AND INVESTIGATION

On average, direct taxation on earnings and profits brings in about 50% of the HKSAR Government's general revenue. Tax avoidance and evasion cause loss to our revenue. Defaults, if not deterred and punished, put our fiscal system at risk. It is also unfair to the honest taxpayers. We agree that it is necessary for the Inland Revenue Department ("IRD") to maintain an aggressive attitude to combat tax evasion.

The following is a summary of the results of the IRD's Field Audit and Investigation for the past 10 years:

<u>Year of Assessment</u>	<u>No. of Cases Completed</u>	<u>Tax and Penalties Assessed</u> \$m
2014/15	1,803	2,533.1
2013/14	1,802	2,540.0
2012/13	1,802	3,447.7
2011/12	1,804	6,003.0
2010/11	1,805	3,827.4
2009/10	1,803	2,590.4
2008/09	1,862	2,181.2
2007/08	1,864	2,528.5
2006/07	1,875	2,196.2
2005/06	1,873	2,118.3

Whilst the total earnings and profits tax has increased by over 80% from \$111,751m in 2005/06 to \$204,949m in 2014/15, the results of the field audit and investigation appear to remain stagnant. The following remark of the Board of Review in *D17/08 (IRBRD Volume 23, 1<sup>st</sup> Supplement)* is worth mentioning:

*"If the Board's experience is anything to go by, there is still a lot more to be done to improve compliance."*

#### RECOMMENDATIONS –

- Establishing a special task force to review the IRD's field audit and investigation work in order to promote compliance.

Our Society has been supporting Hong Kong since 1913 and it is our wish that Hong Kong will strive and prosper in the future.

We will be happy to answer any further questions that you may have. Should you require more



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information, please do not hesitate to contact the undersigned or Ms. Elizabeth Law, Chairman of our Taxation Committee, or Mr. Chan Cheong Tat, Advisor to our Taxation Committee.

Happy New Year of the Monkey!

Yours sincerely

Kam Yiu Shing, Tony  
President

c.c. Mr. K C Chan GBS, JP, Secretary for Financial Services and the Treasury