



# Hong Kong Tax Regime: Where do we go from here?

7 September 2013

Mrs. Yvonne Law, JP  
Tax Managing Partner  
Eminence & Business Development  
Deloitte Touche Tohmatsu

# Hong Kong tax system

- Simple and low tax system
- Types of taxes
  - ❖ Profits tax (16.5% for corporation)
  - ❖ Salaries tax (15% for standard rate)
  - ❖ Property tax (15%)
  - ❖ Stamp duty (*ad valorem*, highest 8.5%)
- Territorial basis – charge of profits tax is governed by Section 14 of the Inland Revenue Ordinance (“IRO”)
  - ❖ A person carried on a trade, a profession or a business in Hong Kong
  - ❖ Profits arising in or derived from such a trade, a profession or a business (excluding profits from sale of capital assets)
  - ❖ Profits must be arising in or derived from Hong Kong

# Tax reform is needed?

- Why tax reform is needed?
  - ❖ Losing competitive edge
  - ❖ Keeping IRO and DIPN up-to-date
  - ❖ Aligning with international tax practices
  - ❖ Securing enough fiscal revenue

# Losing competitive edge

## ➤ Still competitive?

Profits tax / Corporate tax rate	Hong Kong	The PRC	Singapore	Taiwan	Macau
y.e. 31 December 2003	17.5%	33%	22%	25%	15%
y.e. 31 December 2008	16.5%	25%	18%	25%	12%
y.e. 31 December 2013	16.5%	25%*	17%#	17%	12%

\* with preferential tax treatment to preferential industries, e.g. Enterprise Income Tax @ 15%, for High-new tech enterprises

# 75% of the first SGD 10,000 of chargeable income and 50% of the next SGD 290,000 of chargeable income are exempt, effective tax rate may be lower than Hong Kong

# Losing competitive edge (Cont'd)

## ➤ Suggestion

- ❖ Conduct an elasticity study on
  - ❑ (i) Tax rates vs. Tax revenue
  - ❑ (ii) Tax rates vs. Impact on business / domestic investments / overseas investments
- ❖ Determine the optimal tax rate

# Keeping IRO and DIPN up-to-date

- IRO is not updated
  - ❖ No significant change over the years
  - ❖ Existing rules not in line with the business change
    - ❑ Taxpayers operated under contract processing arrangement (CPA) is currently assessed on 50:50 basis (by concession). With the change in the PRC policy, those taxpayers have to transform to import process arrangement (IPA), the operation of which is substantially the same as CPA (in substance). However, the IRD did not extend the concession to those cases under IPA
  - ❖ Needs new legislation
    - ❑ Popularity of e-commerce makes business environment more complicated while the determining factors of the source of income derived from e-commerce is not clearly defined in the IRO
- Departmental Interpretation & Practice Notes (“DIPN”) is not regularly updated
  - ❖ It is issued by the Inland Revenue Department (“IRD”) and serves as a reference on IRD’s point of view on tax treatments
  - ❖ For example, ***DIPN 21 Locality of profits*** shares the IRD’s view on the source of different types of income
  - ❖ DIPN 21 was only updated twice since 1998 (2009 & 2012) over the past 15 years

# Keeping IRO and DIPN up-to-date (Cont'd)

➤ Over the past few years, the determinations of court cases in relation to tax were made and relied on 2 different basis:

- ❖ (i) “Operation test” – Ascertain what the taxpayer has done to earn the profit in question and focus on the place where the profit earning operations took place
- ❖ (ii) “Totality of facts approach” – Consider all relevant factors

It indicated that IRO and DIPN were not clear enough to help taxpayers in determining the taxability of profits

➤ Suggestion:

- ❖ IRO and DIPN shall be reviewed and updated regularly to cope with the changing business environment and tax case law
- ❖ Set the statute of limitation for both profit cases and loss cases to 3 years (practically the same as the PRC) so that taxpayers could have a clear tax position (even for loss cases) and easier to make business decisions

# Aligning with international tax practices

- Globalization led to more cross border transactions
- Stringent approach has been taken by different tax authorities and this led to more tax disputes simultaneously in different tax jurisdictions
- Although Hong Kong was not listed as a tax haven by the Organization for Economic Cooperation and Development (“OECD”), it was blacklisted by some countries, e.g. Italy, as a jurisdiction with low level of taxation and lack of adequate exchange of information
- Following the Double Taxation Agreements signed between Hong Kong and Italy in January 2013, it is expected that Hong Kong can be removed from the Italy’s blacklist
- When PRADA S.p.A., an Italian company, was listed on HKEx in 2011, Hong Kong investors were not familiar with the arrangement of withholding tax on dividend income and other taxes (e.g. Financial Transactions Tax)



# Aligning with international tax practices (Cont'd)

## ➤ Recent development

- ❖ Issuance of *DIPN 47 Exchange of information under comprehensive double taxation agreements* in June 2010
- ❖ Issuance of *DIPN 48 Advance Pricing Arrangement* in March 2012
- ❖ Hong Kong treaty networks

Up to	No. of tax treaties HK entered into
2008	5
2010	17
Current	29

## ➤ Suggestion:

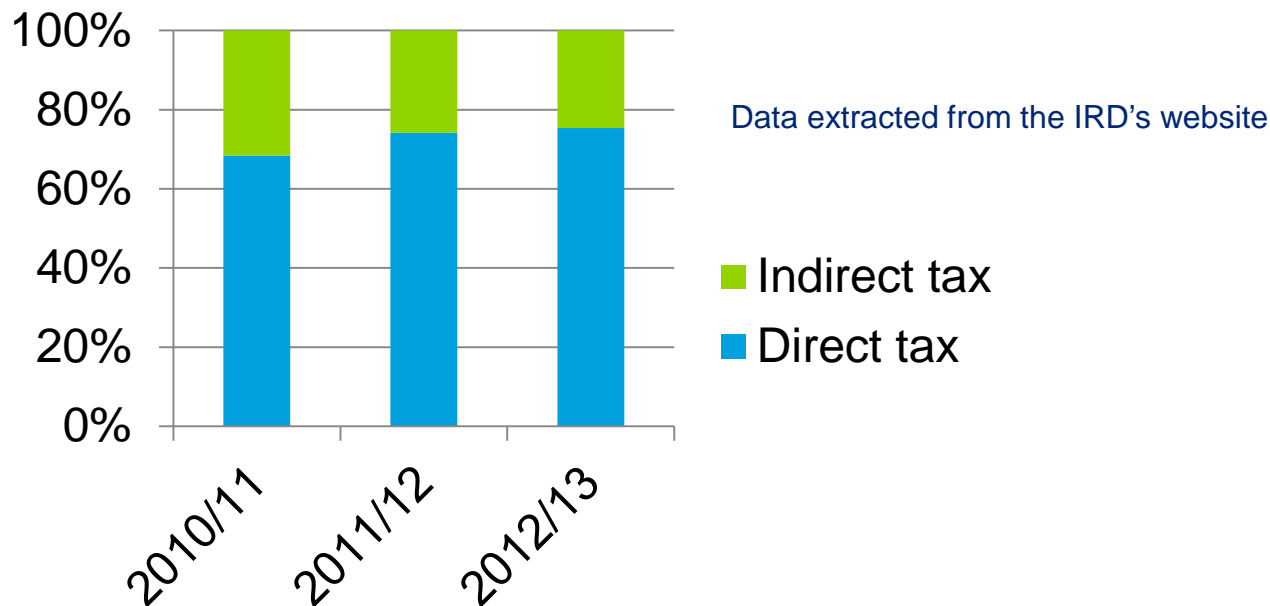
- ❖ Keep on the momentum to extend the DTA network with overseas countries

## ➤ Tax treaty offers:

- ❖ better business environment for investors
- ❖ clear guidelines on withholding tax on dividend/interest/royalty
- ❖ more protection to taxpayers such as avoiding being double taxed

# Securing enough fiscal revenue

- Population ageing
  - ❖ Around 30% of the population of Hong Kong would be aged 65 or above by 2041
  - ❖ Public expenditure on medical and social benefit to elderly is expected to be increasing
  - ❖ Sufficient revenue to finance the future public expenditure?
- Around 90% of total tax revenue was collected from less than 2% of population
- Heavily relying on direct tax



# Securing enough fiscal revenue

- Heavily relying on profits and salaries taxes which we must protect

2010/11			2011/12			2012/13		
Profits tax and salaries tax (HK\$m)	Land premium (HK\$m)	Total revenue (HK\$m)	Profits tax and salaries tax (HK\$m)	Land premium (HK\$m)	Total revenue (HK\$m)	Profits tax and salaries tax (HK\$m)	Land premium (HK\$m)	Total revenue (HK\$m)
137,438 <b>(43.2%)</b>	39,632 <b>(12.4%)</b>	318,442 (100%)	170,361 <b>(45.3%)</b>	65,545 <b>(17.4%)</b>	376,482 (100%)	176,105 <b>(40.2%)</b>	84,644 <b>(19.3%)</b>	437,723 (100%)

Data extracted from the IRD's website and The Treasury

- Suggestion:
  - ❖ Conduct an elasticity study on Profits Tax & Salaries Tax rates vs. Respective revenue

# Securing enough fiscal revenue (Cont'd)

- Suggestion:
  - ❖ Study on introduction/review of new/existing indirect taxes
- (A) Green tax – plastic bag, glass bottle, garbage, etc.
  - Pros:
    - ❖ Broadening the tax base
    - ❖ Relatively independent to the economic cycle
    - ❖ Promote “Green Hong Kong”
  - Cons:
    - ❖ High administration fee
    - ❖ Increase burden on the poor
    - ❖ Disparity between the rich and the poor
- (B) Sales tax – Revisit the feasibility of implementation (first consultation and abandoned in 2006)
  - Pros:
    - ❖ Broadening the tax base
    - ❖ Reliable source of revenue
  - Cons:
    - ❖ High administration fee
    - ❖ Increase burden on the poor
    - ❖ Make the tax system complex
    - ❖ Strong voice of opposition
    - ❖ Dampened people's desire to consume

## Way forward

- Conduct an elasticity study on Tax rates vs. Revenue vs. Investments
- Extend the DTA network with overseas countries
- Review and update the IRO and DIPN regularly
- Study on introduction/reviewing of new/existing indirect taxes

## Overall conclusion

- Tax reform is essentially required

**Deloitte.**