Press release

LCQ2: Enhancing Hong Kong enterprises' competitiveness

Wednesday, March 16, 2011

Following is a question by the Hon Jeffrey Lam and a reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (March 16):

Question:

With regard to enhancing the competitiveness of Hong Kong enterprises, will the Government inform this Council:

(a) given that the revised estimate of the revenue from profits tax for 2010-2011 is $93.5 billion, which is $15 billion (i.e. 19.1%) more than the original estimate, yet the Government has neither reduced the profits tax rate nor introduced the arrangements of "group loss relief" and "loss carry-back", of the reasons for that; whether it has estimated the impact on tax revenue of reducing the profits tax rate for 2011-2012 to 15%;

(b) given that the profits tax rates in the neighbouring regions (e.g. Singapore) are very close to that in Hong Kong, what new measures the Government has in place to enhance the competitiveness of Hong Kong enterprises in response to the calls from the commerce and industry sector over the years; and

(c) how the authorities will dovetail with the "12th Five-Year Plan" formulated by the Central Government and assist the small and medium enterprises in Hong Kong in breaking into the domestic markets of the major cities, as well as the second and third tier ones, on the Mainland (e.g. whether the authorities will consider setting up funds or loan schemes for such purpose)?

Reply:

President,

My reply to the three parts of the question is set out below, covering the reply from the Commerce and Economic Development Bureau (CEDB) in response to part (c) of the question.

All along, Hong Kong has been an attractive world-class city for business operations. Our competitiveness rests with our simple and low tax system, open markets, free flows of information and capital, an independent judiciary, the rule of law, quality professional support services as well as sophisticated infrastructure.

The competitiveness of Hong Kong's tax system lies with our low tax rate and our simple tax regime. The overall tax burden in Hong Kong is one of the lightest in the world. As demonstrated by some international study reports in relation to tax burden of enterprises and individuals, Hong Kong's tax system still upholds its advantages over our competitors in areas of maintaining competitiveness, facilitating business operations and attracting investment. These reports point out that profits tax should not be the only determining factor when assessing the impact of tax regimes on enterprises' competitiveness in various jurisdictions. Other taxation measures affecting enterprises and employees, such as sales tax and contributions made by employers and employees to provident funds, should also be taken into account. For enterprises, our tax system remains as one of Hong Kong's competitive edges not only because we have a relatively low profits tax rate, but also because we surpass many other economies in the region in areas like sales tax and contributions to provident funds.

Profits tax is the largest source of Government revenue, but it is highly sensitive to economic fluctuations. Also, our tax base is narrow. In the year of assessment 2008-09, only some 80,000 corporations (or 13%) out of about 630,000 registered corporations paid profits tax. In other words, nearly 90% of the corporations need not pay any tax. The profits tax paid by the top 1,100 corporations already contributed 67% of the corporate profits tax revenue. Despite the fact that the estimated profits tax revenue for 2010-11 has been revised to $93.5 billion, which is $15 billion more than the original estimate, we should, in considering whether to reduce profits tax rate, assess thoroughly the overall government financial position to ensure that there is sufficient revenue in the long run to cope with increasing public expenditure in the next few years. We should not adjust the tax rates, which would have long-term implications, based merely on the increase of tax revenue in a particular year. As a rough estimate, if the profits tax rate for 2011-12 were reduced to 15%, it would cost the Government around $7.5 billion a year. Given the above, we do not consider it appropriate to reduce the profits tax rate at this stage.

We understand that the business sector would like to enhance its competitiveness by reducing cost. We have provided tax incentives in specific areas while adhering to the taxation principles. For example, 100% tax deduction has been provided to expenditure incurred on research and development as well as purchase of "patent rights", "rights to any know-how", eligible environmental protection machinery and environment-friendly vehicles, even though it is capital in nature. Moreover, to promote wider application of intellectual property rights by enterprises and to facilitate development of creative industries, we have introduced into the Legislative Council on March 9 this year legislative amendments to the Inland Revenue Ordinance to effect the proposal to allow profits tax deduction for capital expenditure incurred on the purchase of "copyrights", "registered designs" and "registered trade marks".

Over the past years, the Government has also introduced various tax measures to promote the development of relevant industries, thereby consolidating Hong Kong's position as an international financial, commercial, tourist and logistics centre. These measures include waiving hotel accommodation tax, waiving the duties on wine, beer and other alcoholic beverages except spirits, exempting offshore funds from profits tax and abolishing estate duty.

The "group loss relief" suggestion involves a number of complicated issues, such as how to ascertain whether companies are members of the same group, and their loss set-off arrangements with each other. The proposed measure could also be easily abused for tax avoidance. Hence, its implementation must be complemented by complicated legislative provisions to define clearly the scope of application so as to avoid tax abuse. This would inevitably complicate our simple tax regime. Separately, as small and medium enterprises (SMEs) in general do not operate as a group, the "group loss relief" suggestion could not benefit the SMEs at large, which constitute 98% of business establishments in Hong Kong.

As for the "loss carry-back" suggestion, since the proposed measure may result in tax refund at any time, it may cause drastic and unpredictable fluctuations in tax revenue, rendering the tax revenue more vulnerable to economic cycles. We believe that our current arrangement for enterprises to carry forward their losses without time limit to offset profits in future years should be able to assist enterprises to manage their losses and remains attractive to investors.

Given the above considerations, we are of the view that it is not appropriate to introduce the "group loss relief" and "loss carry-back" arrangements at this juncture.

The "National 12th Five-Year Plan" affirms the policy of expanding domestic demand. Encouraging Hong Kong enterprises to tap the Mainland domestic market is also one of the major initiatives in the "Framework Agreement on Hong Kong-Guangdong Co-operation" signed between Hong Kong and Guangdong in April last year.

The Hong Kong Special Administrative Region Government has been assisting Hong Kong enterprises in opening up the Mainland domestic market through various efforts. CEDB and relevant departments maintain close liaison with the Mainland authorities at various levels to convey to them the trade's views and discussed with them proposed measures. The Hong Kong Trade Development Council also organises many trade fairs in different Mainland provinces and cities to enhance the awareness over Hong Kong brand products in the Mainland.

As regards financial support, the Trade and Industry Department has in place various funding schemes, e.g. the SME Development Fund (SDF) and SME Export Marketing Fund (EMF), to enhance the competitiveness of enterprises and to assist them in tapping the Mainland domestic market. To strengthen support for SMEs in this regard, CEDB will seek the approval of the Finance Committee of the Legislative Council for injecting $1 billion to the SDF and EMF in the middle of this year.

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