

## Press release

### LCQ12: Revenues from profits and salaries taxes

Wednesday, March 28, 2012

Following is a question by the Hon Paul Chan and a written reply by the Secretary for Financial Services and the Treasury, Professor K C Chan, in the Legislative Council today (March 28):

Question:

It had been shown in the Budgets in the past five years that the fiscal surpluses had often been grossly underestimated by the Government, and there had been, among others, huge difference between the estimated and actual revenues from salaries tax and profits tax. In this connection, will the Government inform this Council:

- (a) of the estimated and actual amounts of the total revenues from salaries tax and profits tax in each of the past five years of assessment, together with the respective percentages of differences between the two amounts (set out in table form by year of assessment);
- (b) of the process and means by which the Government had assessed and estimated the revenues from salaries tax and profits tax in the past five years of assessment; and the reasons for grossly underestimating the actual tax revenues; and
- (c) whether the Government has reviewed the current process for assessing and estimating tax revenues with a view to rectifying the situation of grossly underestimating revenues from salaries tax and profits tax; if it has, of the details; if not, the reasons for that?

Reply:

President,

- (a) Estimates of revenues from profits tax and salaries tax are made on the basis of fiscal year instead of year of assessment. The annex sets out the estimated and actual amounts of revenues from profits tax and salaries tax, and the differences among them for fiscal years 2007-08 to 2011-12.

(b) Hong Kong does not adopt the "pay as you earn" system in collecting taxes. That is, the monthly wages earned by taxpayers would not be charged for salaries tax immediately. Instead, taxpayers are required to file salaries tax returns to the Inland Revenue Department (IRD) in relation to their salary incomes earned in a year of assessment only when that year of assessment is over such that the IRD could make final tax assessment for that past year of assessment. At the same time, the IRD would also estimate the amount of income earned by taxpayers in the current year of assessment based on their income earned in the previous year of assessment with a view to assessing the amount of provisional tax charged for the current year of assessment. In other words, the tax returns filed by taxpayers to the IRD in the current year of assessment contain only information in relation to taxpayers' incomes earned in the previous year of assessment.

Similarly, the information on profits furnished by enterprises in their profits tax returns is related to their profits earned in the previous year of assessment. Since the basis periods of individual enterprises are determined by their accounting end dates, the basis periods of enterprises within a year of assessment can range from as early as from April 2 in the previous year of assessment to the first day of the current year of assessment (i.e. April 1 of the current year of assessment), to as late as from the first day of the current year of assessment (i.e. April 1) to the last day of the current year of assessment (i.e. March 31). In other words, if the accounting years of enterprises start from April 2 each year, the information on profits furnished by those enterprises for the previous year of assessment is data from more than two years ago. For example, the information furnished in the profits tax returns filed to the IRD in 2011-12 is related to the amounts of profits earned by the enterprises concerned in the year of assessment 2010-11. The earliest data could cover the amounts of profits earned by enterprises between April 2, 2009 and April 1, 2010, whereas the latest data could cover the amounts of profits earned by enterprises between April 1, 2010 and March 31, 2011. Of such information, the earliest was data of profits earned from more than two years ago (i.e. April 2009).

It can be seen that, due to the current mode of collecting taxes, the information collected by the IRD every year only captures data of the amounts of incomes/profits earned by taxpayers in the previous year of assessment, which is income/profit data from more than a year or two years or so ago.

As for the preparatory work of Government's Budgets, it starts from around October every year and completes in around February of the following year. In determining the "original estimates" of profits tax revenue and salaries tax revenue of the Government in the next fiscal year, apart from taking into account the information on incomes/profits earned in the previous year of assessment as filed by taxpayers to the IRD, the Administration would also consider the latest performance and outlook of the overall economy, the employment market, the salary adjustment pattern, etc. Since the reference data in relation to incomes/profits earned by taxpayers is from more than a year or two years ago, this may affect the accuracy of the Administration in making the "original estimates" for the revenues from salaries tax and profits tax in the next fiscal year. Besides, tax revenues of the Government will also be affected by the objections and litigations raised by some taxpayers. This is because the completion dates of tax disputes and litigations are in general difficult to control, thus affecting the accuracy of the "original estimates" for tax revenues.

After the determination of the "original estimates" of a particular fiscal year, the Administration would make "revised estimates" for that fiscal year based on the latest assessment data collected in that fiscal year, the overall economic conditions as well as past years' data. As seen from the annex, the differences between the "revised estimates" and the actual revenues from salaries tax and profits tax for the past five years are not substantial.

(c) Hong Kong is a small and open economy which is particularly susceptible to the fluctuation of the global economy and other external factors. As a matter of fact, about 80% of profits tax revenue in the final tax assessment was contributed by trade-related sectors (such as retailing, wholesaling, import and export, manufacturing and shipping) and sectors related to finance, real estate and investment. These business sectors are more volatile than the overall economy, coupled with the fact that profits tax revenue and salaries tax revenue are largely contributed by a small number of enterprises and high-income persons, thus rendering it even more difficult for the Administration to make revenue forecast.

According to the figures for the year of assessment 2009-10, almost 90% of the 688 000 registered corporations did not have to pay profits tax, whereas 69% of the corporate profits tax was contributed by 1 100 corporations (0.16% of registered corporations). As for salaries tax, 200 000 salaries tax payers (6% of the working population) had already contributed 82% of the revenue from salaries tax.

In sum, the fluctuations in revenues from profits tax and salaries tax are often driven by factors beyond the control and anticipation of the Administration, which would inevitably affect the accuracy of the Administration's revenue forecast. As in the past, when estimating revenues from profits tax and salaries tax, the Administration would thoroughly consider the information available at the time and take into account as far as possible the implication of economic changes on revenue.

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