

## **Press Release**

### **LCQ1: Implementation of tax concessions**

Wednesday, July 5, 2017

Following is a question by the Hon Jeffrey Lam and a reply by the Secretary for Financial Services and the Treasury, Mr James Lau, in the Legislative Council today (July 5):

Question:

In recent years, quite a number of neighbouring countries and regions (e.g. Singapore and Taiwan) have offered tax concessions in order to attract foreign investments. The Chief Executive has proposed two tax measures in her election manifesto: (1) introducing a two-tier profits tax rate system and lowering the profits tax rate for the first \$2 million of profit from the current 16.5% to 10% so as to reduce the tax burden on small and medium enterprises, and (2) providing additional tax deductions for research and development expenditure to encourage enterprises to invest in the research and development of new products. On the other hand, the Government will host the Summit on the New Directions for Taxation in the end of this year to explore the way forward for Hong Kong's tax regime. In this connection, will the Government inform this Council:

(1) of the details of and the implementation timetables for the aforesaid two tax measures;

(2) of the date(s) and venue for the hosting of the Summit on the New Directions for Taxation, the list of the speakers and guests to be invited, as well as other details; and

(3) whether it will take the opportunity of hosting the Summit on the New Directions for Taxation to examine, at the same time, the tax proposals put forward by some members of the business sector, which include amending section 39E of the Inland Revenue Ordinance to enable manufacturers to be entitled to allowances in respect of the machinery and plants used in their production procedures located outside Hong Kong, and urging the Mainland authorities, after drawing reference from the legislations on border city tax implemented in Europe, to enact similar legislation stipulating that Hong Kong

residents who have worked on the Mainland for more than 183 days within a year may be exempted from Mainland's individual income tax; if so, of the details; if not, the reasons for that?

Reply:

President,

Hong Kong, as an appealing world-class business city, has been practising a simple, territorial-based and low tax regime. As stipulated in Article 108 of the Basic Law, the Hong Kong Special Administrative Region (SAR) shall, taking the low tax policy previously pursued in Hong Kong as reference, enact laws on its own concerning types of taxes, tax rates, tax reductions, allowances and exemptions, and other matters of taxation. At the same time, Article 107 of the Basic Law provides that the Hong Kong SAR shall follow the principle of keeping the expenditure within the limits of revenues in drawing up its budget, and strive to achieve a fiscal balance, avoid deficits and keep the budget commensurate with the growth rate of its gross domestic product.

On the premise of fiscal prudence and maintaining low tax rates, the SAR Government has introduced various tax measures over the past years to promote the development of relevant industries, with the aim of consolidating Hong Kong's position as an international financial, commercial, tourism and logistics centre. These measures include waiving hotel accommodation tax, exempting duties on wine, beer and other alcoholic beverages except spirits, abolishing estate duty, exempting offshore funds from profits tax, attracting financing companies to develop business in Hong Kong and promoting aircraft leasing business. Meanwhile, we must ensure that these tax policies meet the requirements of the Organisation for Economic Co-operation and Development (OECD) and the European Union so that they will not be regarded as "harmful tax practices".

My reply to the three parts of the question is set out below:

(1) In the 2017-18 Budget, the Financial Secretary announced that a tax policy unit (TPU) would be set up in the Financial Services and the Treasury Bureau. The TPU has three objectives, namely (a) to ensure that our tax regime aligns

with international standards; (b) to leverage our tax policy to promote the development of Hong Kong's economy and industries; and (c) to explore ways to broaden the tax base and increase revenue, with the first priority being to capitalise our tax policy to facilitate the development of Hong Kong's industries and economy. The TPU has commenced its work since late April this year. The first research topic is the provision of enhanced tax deduction on research and development expenditure. The introduction of a two-tiered profits tax system as proposed by the Chief Executive in her election manifesto is another item on TPU's agenda and research on it has already been started. Once specific proposals have been drawn up, the Government will consult the stakeholders concerned.

(2) With the inauguration of the new-term Government on July 1, 2017, we will kick-start the preparatory work to map out the details for the Summit on Taxation later on. Members' views are most welcome.

(3) I appreciate that the business sector and other stakeholders in the community may put forth different suggestions on taxation. In studying these proposals, the Government has to carefully consider important factors such as whether the proposals are consistent with the two fundamental principles of our current tax regime of "territorial source" and "tax symmetry," whether they will easily lead to tax avoidance loopholes as well as how they will impact tax revenue. Section 39E of the Inland Revenue Ordinance (IRO) aims at preventing taxpayers from avoiding taxes through various leasing arrangements for machinery and plants. Taxpayers who let others use the machinery or plants outside Hong Kong are not entitled to capital expenditure allowances. In fact, the Government has reviewed this arrangement before. Our concern is a relaxation of section 39E of IRO to grant capital expenditure allowances on leased machinery and plants will violate fundamental principles such as "territorial source" and "tax symmetry", and may even be regarded as encouraging the transfer of company profits via transfer pricing. This will affect the taxing rights of Hong Kong and other tax jurisdictions. Given OECD has endeavored to combat base erosion and profit shifting of enterprises in recent years with a particular emphasis on reasonable arrangements for transfer pricing, we cannot relax section 39E of IRO easily, lest the relaxation could be regarded as a "harmful tax practice".

Regarding the tax arrangements for cross-border workers, the Mainland

and Hong Kong signed in 2006 the Arrangement between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income (the Arrangement), which allocates the taxing rights of employment income between the Mainland and Hong Kong. Both sides will handle tax assessments on income over which they have a taxing right in accordance with their respective tax laws. Hong Kong residents working in both places may apply for tax relief in Hong Kong under the IRO and the Arrangement if their employment income chargeable to tax in Hong Kong has already been taxed in the Mainland.

According to the Arrangement, one of the key criteria for allocating the taxing right of employment income between the Mainland and Hong Kong is that "the recipient is present in the other side for a period or periods not exceeding in the aggregate 183 days in any 12-month period commencing or ending in the taxable period concerned". The "183-day threshold" is both an international standard and a policy adopted by many tax jurisdictions around the world for identifying their tax residents. It is also fully adhered to by the Mainland tax authorities.

Unlike the Mainland, Hong Kong has a territorial-based tax regime. As such, Hong Kong residents' income derived from the Mainland is not subject to tax in Hong Kong. If Hong Kong residents working in the Mainland on a long-term basis are not required to pay tax in the Mainland, this will result in double non-taxation, which is inconsistent with the principle of fair tax obligation.

Meanwhile, under the preferential policy approved by the State Council, Hong Kong residents working in Qianhai of Shenzhen or Hengqin of Zhuhai have been able to enjoy tax relief for Mainland's individual income tax to offset tax differential between the two places under prescribed conditions since January 1, 2013. For Hong Kong residents who enjoy such tax relief, their actual individual income tax burden in the Mainland is broadly the same as the tax burden they bear for working in Hong Kong.

Looking ahead, we will continue to explore with the Mainland authorities on tax matters concerning Hong Kong residents working in the Mainland as appropriate.

Ends