

A Tax System to Enhance the Business Environment

(14 May 2008) Establishing a specialist Tax Policy Unit within the Financial Services and the Treasury Bureau is the top priority among the five recommendations on the fundamental issues identified in a Bauhinia Foundation Research Centre (“the Centre”) report on the business competitiveness of Hong Kong’s tax system.

The report points out that although Hong Kong’s current tax system is still competitive with many attractive features, many jurisdictions have significantly lowered their statutory tax rates and have introduced preferential tax treatments to retain and attract capital and talent.

“As demonstrated in a study released by the World Bank, Hong Kong has a high effective corporate tax rate despite its low statutory tax rates. In the absence of policy actions, Hong Kong runs the risk of lagging behind its competitors.” said Anthony Wu, the Centre’s Chairman and Co-convenor of the Taxation Study Group.

“Ignoring these issues will only lead to businesses choosing other jurisdictions over Hong Kong, and once they have left, it would be difficult to entice them to return,” he added.

The Taxation Study Group believes that improving business competitiveness will bring more economic activities to Hong Kong, creating more jobs and other multiplier effects, and hence will benefit the whole community.

The Unit, according to the report, should adopt a three-pronged approach to follow up on 12 detailed recommendations with a view to (i) providing greater certainty in Hong Kong’s tax system, (ii) effecting better international integration; and (iii) anticipating and responding to global trends.

“The Unit should be staffed by officials with sufficient seniority, technical knowledge and relevant practical experience. The key mandate of the Unit should be policy research and policy formulation,” said Ayesha Macpherson, Co-convenor of the Study Group.

Elaborating on the roles of the Unit, Ms Macpherson said the Unit is to research and analyse international trends, review and formulate recommendations on how to improve and upgrade tax policies to meet Hong Kong’s economic and social objectives, implement tax changes and solicit views from the business and professional sectors.

“We recommend that the Financial Secretary appoint and chair a standing advisory committee to advise the Unit, which will form an important anchor and pillar to keep Hong Kong’s tax system efficient and competitive,” she added.

The Study Group also recommends a new value proposition for Hong Kong’s fiscal policy based on competitiveness as the underlying principle.

While simplicity is an important principle for a good tax system, the report argues that business transactions are becoming ever more complex and sophisticated, and a simple tax system alone may not be able to cater to changes in the business world.

“The result could be uncertainty and uncompetitiveness, and there are situations where simplicity per se should be sacrificed in favour of competitiveness.

“To stay competitive, Hong Kong needs to strike a balance among certainty, efficiency and effectiveness as well as low tax rates,” Ms Macpherson said.

In particular, the Study Group takes the view that there is an urgent need to provide greater certainty in the application of the source concept for profits tax and in the determination of the source of employment income.

Before contemplating any necessary changes, the Study Group considers it useful to retain the good elements of the existing tax system, which include our limited number of taxes, source concept of taxation, tax exemption of profits from the sale of capital assets and low statutory tax rates, etc.

Instead of using tax incentives to attract investments, the results of a business survey and interviews in the study confirm that clarity of tax law and certainty of tax administration are more important factors than sector-specific tax incentives.

“For the time being, we believe Hong Kong should focus on providing a favourable tax environment across the board, rather than being distracted by calls for sector/industry-specific tax incentives where the cost/benefit is not clear, and which could be perceived as inequitable,” said Ms Macpherson.

Amongst its 12 detailed recommendations, the Study Group sees a need to exert greater efforts in building a comprehensive double tax agreement (“DTA”) network and to introduce group loss relief and tax loss carry-back rules.

“Building a comprehensive DTA network would clearly enhance Hong Kong’s position as an international business centre. This is all the more important if Hong Kong were to capitalize on the Mainland’s outbound investments,” said Ms Macpherson.

“Many jurisdictions now allow tax losses to be utilized on a group basis and to be carried back. Hong Kong’s tax loss provisions need to be more flexible,” she added.

The Study Group also advocates alignment of Hong Kong’s tax system with its macro-economic goals.

As part of the study, a survey of the local business sector and interviews with senior business executives were conducted to gauge the views of the business community on Hong Kong’s tax system.

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