

Assessing Functions

The Department raises revenue through taxes, duties and fees in accordance with the relevant legislations. While the duties and fees collected for a year are based on the actual results of the year, the Earnings and Profits Tax assessed are principally computed by reference to the incomes/profits of the taxpayers in the previous year. For 2005-06, the Earnings and Profits Tax assessed increased by \$15.5 billion (15%), as compared with the previous year. The total of duties and fees collected also rose by 7%.

Profits Tax

Profits Tax is levied on individuals, corporations, bodies of persons and partnerships, in respect of assessable profits arising in or derived from Hong Kong. For the year of assessment 2005-06, the Profits Tax rates for corporations and non-corporate persons remained unchanged at 17.5% and 16% respectively.

With a strong economic rebound and favourable business operating performance across all business sectors, Profits Tax assessed in 2005-06 increased by \$12.0 billion (19%), as compared with the previous year. Total Profits Tax assessed during the year amounted to \$76.2 billion (**Figure 5**). Of the total tax assessed, the property and financial sectors together contributed 38.1% (**Figure 6**). Further statistics relating to the tax assessed in respect of different business sectors are shown in **Schedules 3 and 4**.

Figure 5 Profits Tax assessed

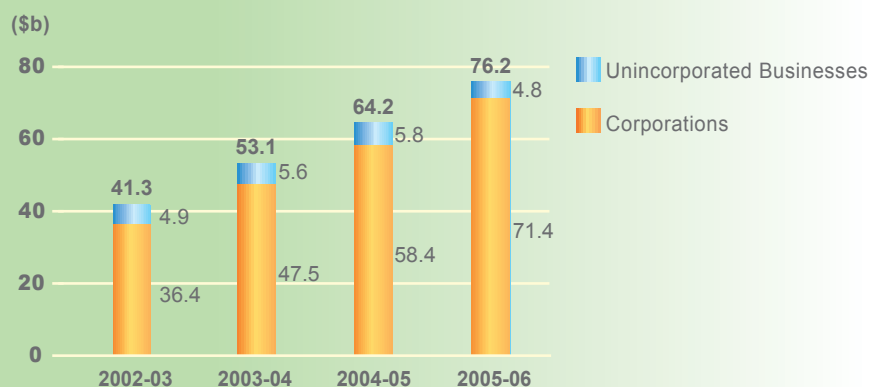
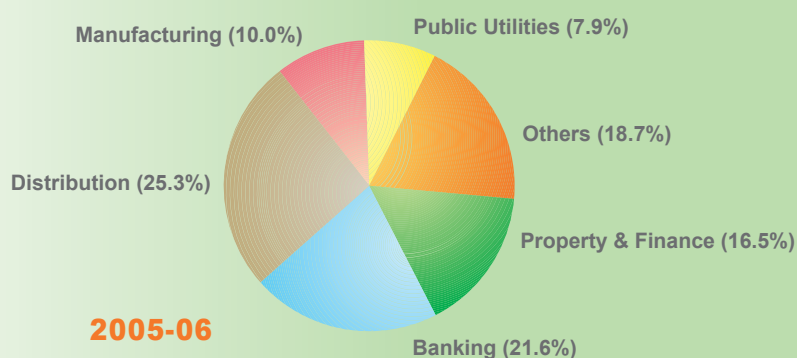


Figure 6 Corporate Profits Tax assessed ratios by business sectors



Salaries Tax

Salaries Tax is charged on all income arising in or derived from Hong Kong from any office (e.g. a directorship), employment or pension. The total tax payable is restricted to an amount not exceeding the standard rate of Salaries Tax of the net total income (without allowances) of the individual concerned. For the year of assessment 2005-06, the standard rate remained unchanged at 16%.

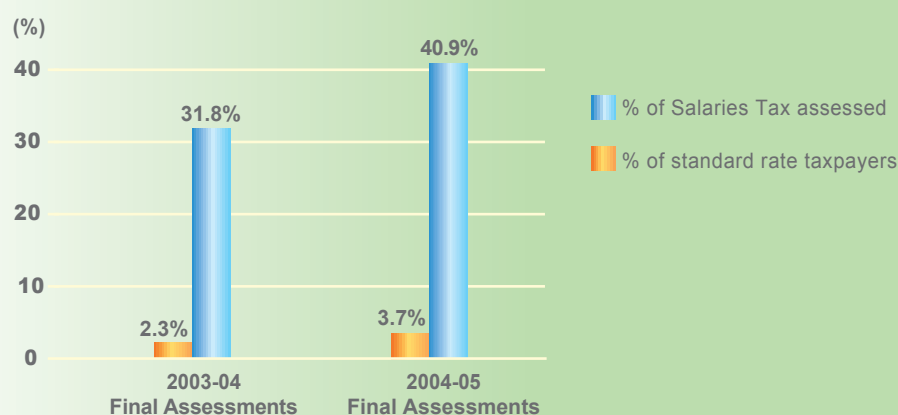
As compared with the previous year, the number of assessments made increased slightly by 1.5% and 8.9% more tax was assessed during 2005-06 (**Figure 7**). Analyses of tax assessed and allowances granted in respect of taxpayers at various income levels are provided in **Schedules 5** and **6**.

Figure 7 Salaries Tax assessments



Following the implementation of phase II tax increase measures in the 2003-04 Budget, the number of standard rate taxpayers increased by 19,088, from 26,729 last year to 45,817 this year. These taxpayers together contributed 40.9% of the Salaries Tax assessed, compared to 31.8% last year (**Figure 8**).

Figure 8 Standard rate taxpayers



Notification Requirements of Employers

Apart from reporting commencements and cessations of employments, employers are required to prepare annual returns to report the emoluments of each of their employees. During the year, 248,673 employers filed employer's returns with the Department.

The Department provides venues for e-Seminar and disseminates tax information for employers on the IRD Homepage in order to enhance their understanding of the relevant statutory requirements. The contents include information about completion of employer's return, employer's obligation, answers to frequently asked questions. Employers can also obtain specimens of completed employer's returns and notifications through the Fax-A-Form service.

Property Tax

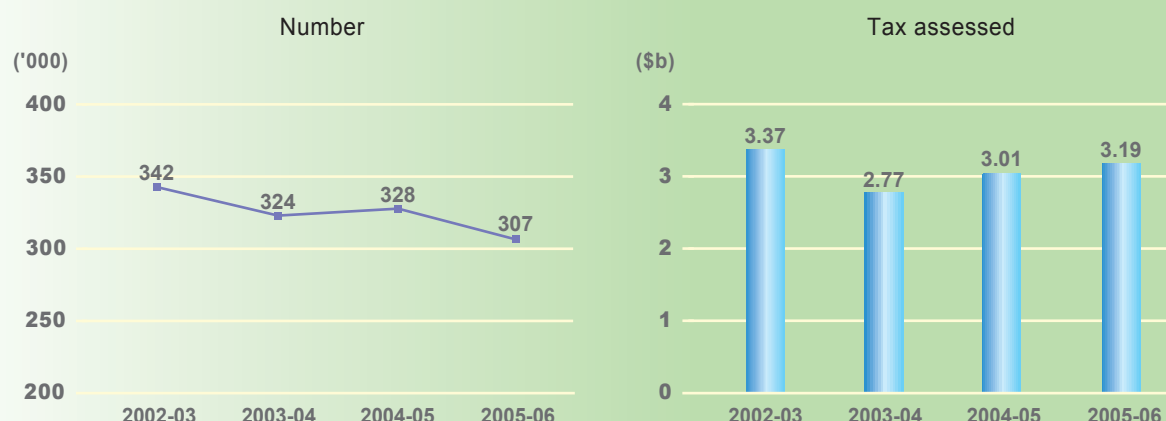
Property owners (including corporations) are subject to Property Tax which is charged at the standard rate in respect of the net assessable value of the property. For the year of assessment 2005-06, the standard rate remained unchanged at 16%. Incorporated and unincorporated businesses that pay Property Tax in respect of their business premises can have such payments set off against their Profits Tax liabilities. As for corporations, income arising from properties owned by them is also subject to Profits Tax at the corporate tax rate. To obviate the need for yearly set-off of Property Tax against Profits Tax, a corporation can apply for exemption of Property Tax on the property concerned. Statistics on the classification and ownership of properties, based on the records of the Department, are provided in **Schedule 7**. The number of assessments made during the year increased by 2.8%, as compared with the previous year. Reflecting a steady rising trend in rents throughout the year, the amount of Property Tax assessed increased by 14.1% (**Figure 9**).

Figure 9 Property Tax assessments



Personal Assessment

An individual may elect Personal Assessment in respect of his or her total income. Under Personal Assessment, all of the income of the taxpayer and his or her spouse is aggregated and, after the deduction of all allowances, is assessed at the graduated tax rates. In appropriate circumstances, this reduces the total tax liability of the individual (e.g. an individual who would otherwise be chargeable at the standard rate on each separate income source). As a result of a decrease in the number of elections, the number of assessments made in 2005-06 was 6.3% less than the previous year. With the further reduction of personal allowances for the year of assessment 2004-05, the amount of tax assessed increased by 5.9% (**Figure 10**).

Figure 10 Assessments made under Personal Assessment

Advance Ruling

The advance ruling service allows a person to apply for a ruling on how a provision of the Inland Revenue Ordinance applies in relation to a particular arrangement.

A fee is charged for the service on a "cost recovery" basis. Initially, the applicant is required to pay an application fee of \$30,000 for a ruling concerning the "Territorial Source Principle", or \$10,000 for a ruling on any other matter.

The Department endeavours to provide a ruling within 6 weeks of the date of application, provided that all relevant information is furnished with the application and further consultation with the applicant is not required.

During the year, 33 advance ruling applications were processed (**Figure 11**). Most of the applications were for rulings on Profits Tax matters.

Figure 11 Advance Ruling

	2004-05 Number	2005-06 Number
Awaiting decision at the beginning of the year	19	13
Add: Applications received during the year	<u>71</u>	<u>30</u>
	90	43
Less: Disposed of -		
Ruling made	66	27
Application withdrawn	7	5
Ruling declined	<u>4</u>	<u>1</u>
	77	33
Awaiting decision at the end of the year	<u><u>13</u></u>	<u><u>10</u></u>

Objections

A taxpayer who is aggrieved by an assessment made under the Inland Revenue Ordinance may lodge an objection to the Commissioner. A significant proportion of the objections received each year arises from estimated assessments issued to taxpayers who fail to lodge returns on time. An objection of this nature must be supported by a completed return and, where applicable, by supporting accounts. Most of these objections are settled promptly by reference to the returns subsequently submitted. Many of the other types of objections are also settled by agreements between the taxpayers and the assessors concerned. Relatively few objections are ultimately referred to the Commissioner for determination. During the year, the Department processed over 69,900 objections (**Figure 12**).

Figure 12 Objection statistics

		2004-05	2005-06
		Number	Number
Awaiting settlement at the beginning of the year		26,418	24,354
Add: Received during the year		71,654	72,192
		98,072	96,546
Less: Disposed of -			
Settled or withdrawn	72,838		69,137
Assessment confirmed	496		459
Assessment reduced	228		213
Assessment increased	128		119
Assessment annulled	28	73,718	13
		<u>73,718</u>	<u>69,941</u>
Awaiting settlement at the end of the year		<u>24,354</u>	<u>26,605</u>

Appeals to the Board of Review

A taxpayer who is dissatisfied with the Commissioner's determination of his objection may appeal to the Board of Review (Inland Revenue Ordinance) to have the determination reviewed. As at 31 March 2006, the Board consisted of a chairman and 10 deputy chairmen, who have legal training and experience, as well as 115 other members. During the year, the Board processed 124 appeals (**Figure 13**).

Figure 13 Appeals to the Board of Review

	Number
Awaiting hearing or decision as at 1 April 2005	84
Add: Lodged during the year	122
	<u>206</u>
Less: Disposed of-	
Withdrawn	29
Assessment confirmed	44
Assessment reduced in full	7
Assessment reduced in part	26
Assessment increased	12
Assessment annulled	4
Others	2
	<u>124</u>
Awaiting hearing or decision as at 31 March 2006	<u>82</u>

Appeals to the Courts

A decision of the Board of Review is final, provided that either the taxpayer or the Commissioner may, pursuant to section 69(1) of the Inland Revenue Ordinance, make an application requiring the Board to state a case on a question of law for the opinion of the Court of First Instance. Apart from appeals by way of case stated, occasionally the parties may lodge appeals to the Court through judicial review proceedings.

During 2005-06, the Court of First Instance ruled on fourteen cases relating to the Inland Revenue Ordinance. Six of these involved judicial review applications with five made by taxpayers and one by the Commissioner. Judgments in all six cases were in favour of the Commissioner. As for the other eight cases, judgments in favour of the Commissioner were given in six cases and the issues covered the deductibility of interest expenses, the Commissioner's right to revisit a loss computation of more than six years ago, application of the anti-avoidance provisions, the source of employment income, the taxability of profits from the sale of property, and the nature of loss arising from the sale of shares by an individual. The Court ruled against the Commissioner in two cases which involved the source of brokerage income and whether payment to an employee was a rent reimbursement.

Of the fourteen judgments delivered by the Court of First Instance, there were appeals to the Court of Appeal by the taxpayers in four cases. The Commissioner has also lodged appeal in the two cases which were dismissed by the Court of First Instance.

During the year the Court of Appeal handed down five judgments, all in favour of the Commissioner, relating to the Inland Revenue Ordinance. The taxpayers in three of these cases, which involved the taxation of royalty income, the deduction of interest expenses and the source of brokerage income, have applied for leave to appeal to the Court of Final Appeal.

Figure 14 sets out statistics concerning appeals to the Courts for 2005-06.

Figure 14 Appeals to the Courts

					Court of First Instance	Court of Appeal	Court of Final Appeal	Total
Awaiting hearing or decision as at 1 April 2005					22	4	-	26
Add: Lodged during the year					22	9	1	32
					<u>44</u>	<u>13</u>	<u>1</u>	<u>58</u>
Less: Disposed of -								
Decided					14	5	-	
Discontinued					12	-	-	
					<u>26</u>	<u>5</u>	<u>-</u>	<u>31</u>
Awaiting hearing or decision as at 31 March 2006					<u>18</u>	<u>8</u>	<u>1</u>	<u>27</u>

Business Registration

The Department aims to maintain an efficient business registration system. Every person carrying on business in Hong Kong must register the business and pay the required fee. Registered businesses may renew their registration certificates either annually or once every 3 years. The registration fee and levy for the Protection of Wages on Insolvency Fund are respectively \$2,000 and \$600 if paid annually, or \$5,200 and \$1,800 if paid every three years. Up to 31 March 2006, 10,980 businesses had taken the 3-year certificates.

As the economy expanded, the total number of new and re-opened registrations in 2005-06 was 9,263 higher than that of the previous year while the number of cancelled registrations decreased by 9,517 (**Schedule 8**). The total number of active registrations recorded a growth of 40,837 for the year (**Figure 15**). There was a corresponding increase in the number of certificates issued, leading to an increase of \$130 million in the business registration fees collections (**Figure 16**).



Figure 15 Active Business Registration

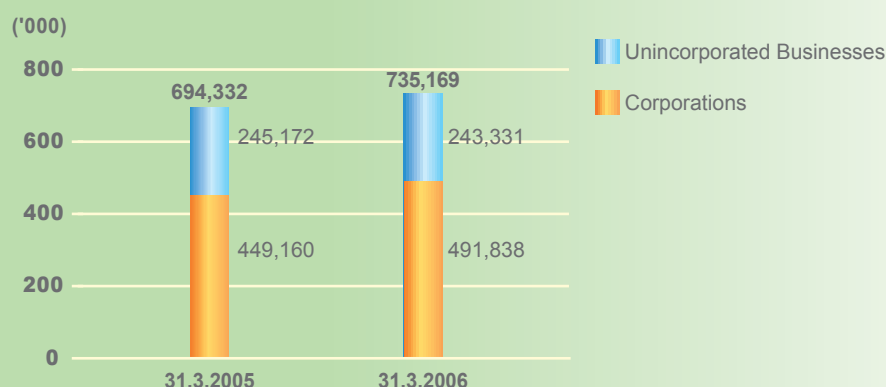


Figure 16 Certificates issued and Fees collected

	2004-05	2005-06	Increase
Number of certificates issued (Main and Branch)	733,825	796,126	8.5%
Fees (inclusive of penalties) (\$m)	1,348.7	1,478.8	9.6%

Under the Business Registration Ordinance, a small business with average monthly sales or receipts below a specified limit (\$10,000 for a business mainly deriving profits from the sale of services or \$30,000 for other businesses) could apply for exemption from payment of the fee and levy. The number of total exemptions granted during the year was 17,520, representing an increase of 10% from the previous year.

Where an application for exemption is not allowed, the business operator may appeal to the Administrative Appeals Board. 7 appeals were received by the Board in 2005-06, of which 1 was dismissed by the Board. The remaining cases were subsequently withdrawn by the appellant (Figure 17).

Figure 17 Appeals to the Administrative Appeals Board

	Number
Awaiting hearing as at 1 April 2005	3
Add: Lodged during the year	<u>7</u>
	10
Less: Disposed of-	
Appeal dismissed	1
Appeal withdrawn	9
	<u>10</u>
Awaiting hearing as at 31 March 2006	<u>0</u>

Stamp Duty

Stamp Duty is charged on instruments effecting property and stock transactions and leasing of property (Figure 18).

Despite the interest rate hikes in 2005-06, the property market recorded a steady growth during the year. The stamp duty collections from property transactions grew by 3% when compared with the previous year.

The stock market remained active throughout the year, in particular in the 4th quarter. The stamp duty collections from share transactions rose by 27% when compared with the previous year.

Overall, there was an increase of 13% in total stamp duty collections during the year (Figure 19 and Schedule 9). The number of documents stamped, also, increased by 12% (Schedule 10).

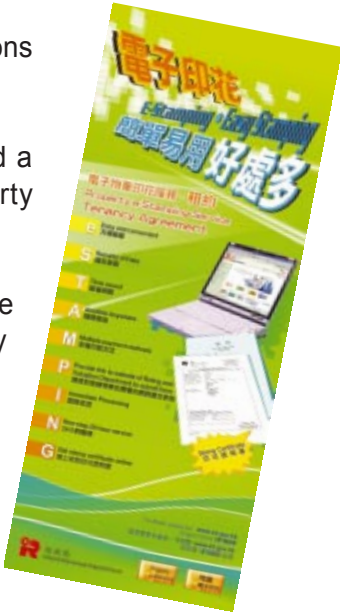


Figure 18 Composition of Stamp Duty collections

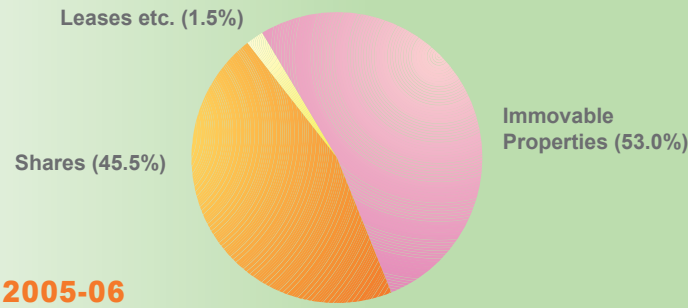


Figure 19 Stamp Duty collections

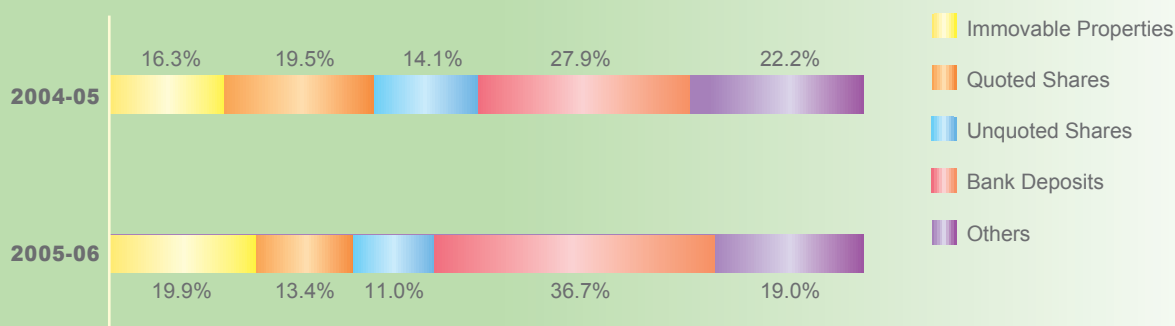
	2004-05 (\$m)	2005-06 (\$m)	Increase
Immovable Properties	9,233	9,466	+3%
Shares	6,388	8,129	+27%
Leases etc.	230	272	+18%
Total	15,851	17,867	+13%

Estate Duty

Estate duty is charged on that part of a deceased person's estate situated in Hong Kong. The threshold for levying duty is \$7.5million and the duty rates range from 5% to 15%, depending on the value of the estate.

The Revenue (Abolition of Estate Duty) Ordinance 2005 ("the Ordinance") has abolished estate duty in respect of persons passing away on or after 11 February 2006. The Ordinance has extended the benefit of abolition to cases of deaths occurring on or after 15 July 2005 but before 11 February 2006, by imposing a nominal duty of \$100 on such estates if the assessed value exceeds \$7.5 million.

Figures 20 and 21 show the composition of estates and cases processed for the past two years.

Figure 20 Composition of Estates**Figure 21 Estate Duty cases**

	2004-05	2005-06
New cases	<u>16,064</u>	<u>16,717</u>
Cases finalised		
Dutiable	271	309
Exempt	15,660	16,696
	<u>15,931</u>	<u>17,005</u>

Estate Duty of \$1.675 billion was collected during the year (**Schedule 11**), an increase of \$207 million (14.1%) compared with that of the previous year.

Estate Duty is payable on delivery of an estate duty affidavit or account (or within 6 months from the date of the deceased's death, whichever is the earlier). \$1.497 billion was received during the year in advance of the issue of formal assessments (**Schedule 12**).

Betting Duty

Betting Duty is charged on bets made on totalisators at race meetings conducted by the Hong Kong Jockey Club, on the proceeds of lotteries conducted by the HKJC Lotteries Limited and on the net stake receipts from the conduct of authorised betting on football matches by the HKJC Football Betting Limited.

In 2005-06, the rates of duty remained unchanged (**Figure 22**).

Figure 22 Rates of Betting Duty in 2005-06

		Rate
Standard Bets	win, place, double, quinella and quinella place	12% *
Exotic Bets	six up, treble, tierce, trio, double trio and triple trio	20%
Lotteries		25%
Football Betting		50% **

Note: * Overseas bets are charged at 6%.
 ** Duty rate on the net stake receipts.

During the year, both the racing attendance and the bets on horse racing decreased continuously (**Schedule 13**), resulting in a drop of 6.1% in the duty collected from horse racing. The lotteries duty collections slightly decreased by 1.7%. However, the drops were slightly offset by an increase of 22.1% in football betting duty collections. Total betting duty collections in 2005-06 was only 1% lower than the previous year (**Figure 23**).

Figure 23 Betting Duty collections

	2004-05 (\$m)	2005-06 (\$m)	Increase/Decrease
Horse Racing	8,466.7	7,949.9	-6.1%
Lotteries	1,662.2	1,633.4	-1.7%
Football Betting	1,928.3	2,354.8	+22.1%
Total	12,057.2	11,938.1	-1.0%

Hotel Accommodation Tax

Hotel Accommodation Tax is imposed on hotel and guesthouse accommodation at the rate of 3% of the accommodation charges paid by guests and is collected quarterly in arrears.

In 2005-06, there was an increase in the number of hotels, boarding houses and taxable rooms (**Figure 24**). Though the average room occupancy rate slightly decreased by 2.3% (**Figure 25**), the average room charges increased (**Schedule 14**). Total tax collected in the year was 25.3% higher than that of the previous year (**Figure 26**).

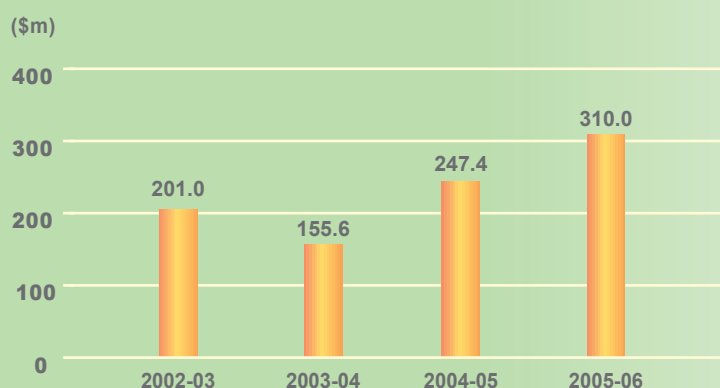
Figure 24 Hotels, boarding houses, taxable rooms and exempted rooms

	2004-05	2005-06	Increase
Hotels and Boarding Houses	183	199	+8.7%
Taxable Rooms	42,038	45,710	+8.7%
Exempted Rooms	5,986	6,591	+10.1%

Figure 25 Room occupancy rates

	2004-05	2005-06	Increase/Decrease
Room Days	11,751,790	12,643,941	+7.6%
Occupancy Rate	87.1%	84.8%	-2.3%

Figure 26 Hotel Accommodation Tax collections



Tax Reserve Certificates

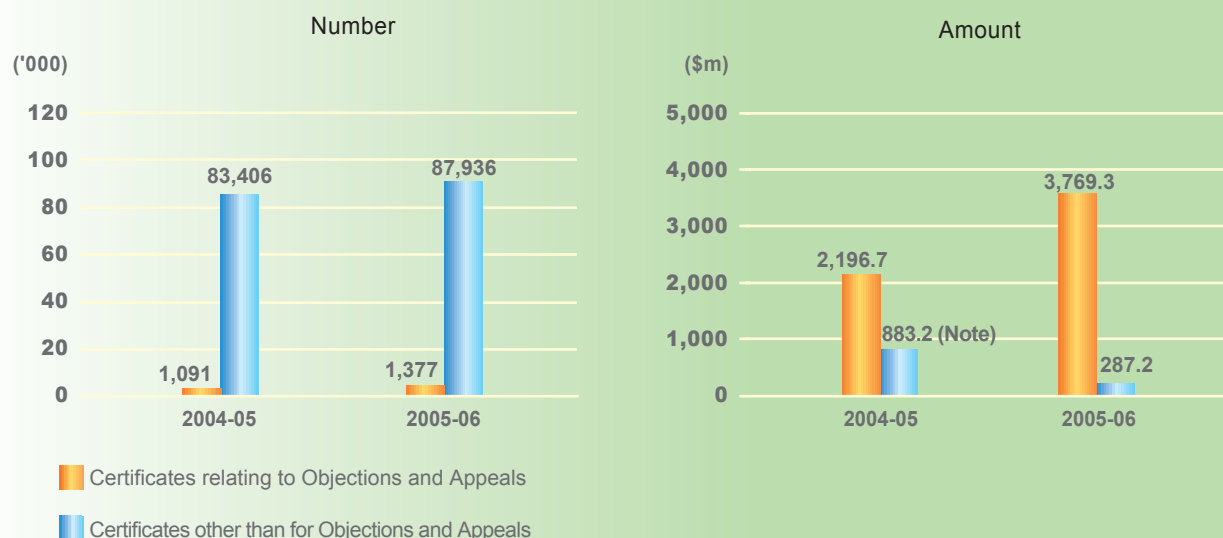
There are two sets of circumstances under which Tax Reserve Certificates are purchased.

The first applies to taxpayers who wish to save for the payment of their future tax liabilities. Two service schemes are offered to these taxpayers: the "Electronic Tax Reserve Certificates Scheme" for all taxpayers and the "Save-As-You-Earn" (SAYE) Scheme for civil servants and civil service pensioners. Under the Electronic Tax Reserve Certificates Scheme, certificates can be purchased using various electronic means, i.e. by bank autopay, telephone, the Internet and bank ATM. Under the SAYE Scheme, certificates are purchased by civil servants and civil service pensioners through monthly deductions from their salaries/pensions. Interest is payable on the certificates when they are redeemed for settlement of tax liabilities, based on the interest rate prevailing at the time of purchase, for a maximum period of 36 months from the date of purchase.

In 2005-06, there was an increase of 8% and 4% in the number of certificates sold under the Electronic Tax Reserve Certificates Scheme and the SAYE Scheme respectively. However, the amount of certificates sold under both schemes dropped 76% (see note below) and 5% respectively (**Schedule 15**). The total amount of certificates sold decreased by 67% (**Figure 27**).

The second situation applies to taxpayers who object to tax assessments and are required to purchase Tax Reserve Certificates in respect of the tax in dispute. Such certificates are used to settle any tax found payable upon the finalisation of the objection or appeal. Interest is only payable on the amount, if any, subsequently required to be repaid to the taxpayer, and is computed at floating rates ruling over the tenure of the certificate.

Figure 27 Certificates sold



Note: a single sizable sale in 2004-05 boosted the amount under the Electronic Tax Reserve Certificates Scheme by 240% as compared with the previous year.