

**Launch Reception of the Taxation Interest Group of
the Hong Kong Institute of Certified Public Accountants**

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10 June 2005

Distinguished guests, Ladies and Gentlemen,

It is my pleasure to be here today at the launch reception of the Taxation Interest Group of the Hong Kong Institute of Certified Public Accountants.

Introduction

2. Hong Kong may be small in geographic size and population in comparison with our neighbours in the region. With efforts contributed by all quarters in the community, we have been successful in establishing our status as one of the leading economies in the Region. We rank first in 2005 for the 11th consecutive year (since the index's inception in 1995) amongst 161 places as the freest economy in the world, according to the Index of Economic Freedom published jointly by the Heritage Foundation and the Wall Street Journal. One of the criteria adopted in determining the ranking is taxation. **Our simple, low-rate, easy-to-administer and easy-to-comply taxation system is undoubtedly a major contributory factor to our success in the past.** Indeed, the Economist wrote a few years ago that "The Territory's (i.e. Hong Kong's) tradition of simple and low taxes ... is widely seen as a main reason for its stunning rise to prosperity."

3. Like other taxation jurisdictions, our taxation regime cannot afford to be static. The world trend of globalization and the fast economic developments in the Mainland have, on the one hand, created much opportunity for businesses. On the other hand, they brought in competitions among our neighbouring economies. These developments, accompanied by the rapid change in the financial and business environment in Hong Kong, have always been a great challenge to our taxation system. **We are always alert to bringing our tax system up-to-date and compatible with the latest developments.** We need to maintain our edges in attracting investments and reinvestments and, in particular, to respond in areas where our competitors have aggressively sharpened their edges through taxation policies.

Regular Review of the Taxation System

4. In the earlier years of implementing our taxation law, there were only occasional amendments to the Inland Revenue Ordinance (“the Ordinance”). We then adopted an ad hoc approach to conduct reviews of the Ordinance. Three Inland Revenue Ordinance Review Committees were set up in 1952, 1966 and 1976 to consider the stock of taxation issues brought up by businesses and professional associations as well as by the Administration itself in the interim. The Review Committees came up with proposals for amending the Ordinance; those that were considered viable by the Administration were implemented subsequently. This mode of conducting ad hoc reviews was effective at a time when the economic environment was less buoyant.

5. Since the 1980s, we have kept the various tax items under constant review to cope with the ever-changing economic and social conditions. In other words, **we have been reviewing our tax law regularly**. This resulted in the establishment in 1987 of the cross-sector Joint Liaison Committee on Taxation, of which the HKICPA is a constituent member, to advise the Administration on taxation policy and implementation of the tax law. This aside, we also review various tax items in the context of the annual budget exercises. The reviews had brought about substantial enhancements to the taxation regime, both for achieving fiscal objectives and for improving our taxation system with a view to increasing the competitive edges of Hong Kong.

6. In addition to the regular reviews of our tax system, the Administration had also conducted a number of reviews on specific taxation policies in recent years. In 1997-98, for instance, the Administration established a Working Group on Profits Tax Review to conduct a comprehensive and in-depth review of the profits tax system. A number of reforms to the profits tax system were implemented as a result. An example is the introduction of an advance ruling system on taxation matters. An Advisory Committee on New Broad-based Taxes was established in 2000 to consider the types of broad-based taxes suitable for introduction in Hong Kong, based on the principles of maintaining a simple taxation regime and preserving our competitiveness. More recently, the Administration set up an Estate Duty Review Committee last year to consider the retention of estate duty. We believe that the regular reviewing process together with ad hoc studies on targeted taxation policies are capable of keeping track with the fast changing current developments.

Co-operation between HKICPA and IRD

7. The Administration cannot work alone in the bid to perfect our taxation regime. In this regard, I must express my whole-hearted gratitude to the unfailing support of the HKICPA. The Institute spends great efforts every year in studying the taxation policies and makes annual submissions to the Financial Secretary on fiscal matters and taxation policy issues. Besides, the Institute has given numerous pieces of advice to the IRD on various taxation issues that are in the public interest and of interest to the tax practitioners and accountants. The Institute and the IRD holds annual meetings to exchange views on the practical matters relating to the administration of the Inland Revenue Ordinance. We always treasure the annual meetings and other channels of communication between the Institute and the IRD. Minutes of the annual meetings published by the Institute on its website are valuable sources of up-to-date tax information, not only to the practitioners but to the IRD officers as well.

The TIG

8. I must thank Paul and his team for having taken time to explain to my officers and me the idea of forming the Taxation Interest Group a week ago. With the active participation of the practitioners, I believe that TIG will be **an excellent forum to exchange views and share experience on taxation matters**. I hope that through the participation of officers from the IRD, TIG will serve as **a channel for IRD to communicate directly with the practitioners**. Paul told me that the objective of TIG is to promote collaboration and experience sharing among the practitioners as well as between the practitioners and IRD. I share his view that TIG will be an excellent venue for IRD to gauge the views of the industry and, at the same time, to clarify and discuss tax matters of common interest. I anticipate that the practitioners and the IRD will work hand in hand to sort out problems, which can be resolved later by refining the assessing practice, and to identify issues, that may call for amendments to the legislation, for more detailed deliberation by the Administration.

Standardization of Tax Computations

9. One issue worthy of the attention of TIG that I mentioned to Paul earlier is the standardizing of the format of tax computation and accounts for filing the Profits Tax Return. I fully appreciate the pressure on tax practitioners in meeting the deadlines of filing tax returns for their clients. As there is no standard format of the tax computation, tax practitioners may have to spend a lot of time and effort in

preparing the tax computation manually for each individual client. The non-standardized format of the tax computation is a hurdle to introducing electronic filing of profits tax returns. While the large practitioner firms can develop their own standard format of computation for the purpose of automating their work, the smaller practitioners may not have the resources to do so. It will be desirable for the TIG to explore together with IRD the possibility of designing some standard format of tax computations so that it can be uniformly used by the practitioners. As a next step, IRD is prepared to prescribe specifications for developing software that helps automate the preparation of the tax computations as well as their electronic submission to IRD. We shall lend our support to the initiative to achieve a win-win result.

Penalty Policy

10. Another issue that many practitioners may be interested to understand better is the IRD's policy in imposing penalty for late submission of tax returns. We have published on the IRD website the scales of imposing penalties for late submission of tax returns in cases where no tax audit or investigation is involved. Higher penalty will be levied for repeated offences. In the extreme case, penalty levied can be up to 50% of the amount of tax undercharged for the third or more offence in five years. We welcome suggestions from the practitioners on the ways to modify the penalty policy on late filing of returns with a view to striking a balance between maintaining fairness and providing sufficient deterrence to the late filers.

Cross-border Tax Issues

11. Cross-border tax issues are another area of interest to those engaged in cross-border businesses and those who take up employment at the other side of the border. The SAR Government has entered into an arrangement with the Mainland for avoidance of double taxation on income in 1998. This Arrangement, unfortunately, is of limited scope and has not dealt with all aspects of income tax. There are therefore calls for the SAR Government to enter into a comprehensive arrangement with the Mainland as well as DTAs with other tax jurisdictions.

12. On this subject, I am pleased to inform you that we have today announced on the IRD website that Hong Kong will soon **start negotiation with the State Administration of Taxation of the Mainland for a comprehensive DTA**. I am sure that many practitioners may wish to express their views on the terms of the

Comprehensive Arrangement. Among other things, I think the following issues may deserve some deliberation in the negotiation.

Exchange of Information

13. Up to now, Hong Kong SAR adopts an approach of accepting limited scope of exchange of information when negotiating DTAs with other countries. We only agree to share the information of our own taxpayers, as permitted under the existing provisions of the IRO, with our counterpart under a DTA. Developed countries nowadays prefer a wider scope of exchange of information provisions under the DTAs. Such demands are reflected in the latest version of the OECD Model Tax Convention for DTAs. These requirements have been a hurdle for us to conclude DTAs with many of the developed countries. The Administration needs to gauge the views of the professional and business sectors in this regard before deciding on the way forward. Legislative amendments may at the end of day be necessary.

Transfer Pricing Rules

14. I also note that there are calls to consider the inclusion of transfer pricing rules in the Comprehensive Arrangement with the Mainland with a view to providing certainty to cross-border traders. In the light of the low tax rate of Hong Kong, transfer pricing issue has not posed much problem in Hong Kong. Besides, we have provisions dealing with transfer pricing problem to some extent under section 20 of the IRO. Experience from other countries with transfer pricing legislation indicates that such a regime is complicated and not easy to administer. It needs the back-up of a strong database of prices and tedious procedures for granting advanced pricing arrangements. The provisions are prone to abuses and disputes on the scheme are frequent. Nevertheless we are open-minded on this issue and welcome views from the practitioners as well as from the business sector.

15. The foregoing are just some of the issues of interest to the practitioners; there are many other issues of equal interest. I earnestly hope that TIG will be able to function as a channel of two-way flow of ideas and experiences between the practitioners and the IRD. I will surely relay the constructive ideas on the taxation policy to the policy bureau for deliberation.

16. Lastly, I wish the TIG every success and I look forward to working hand in hand with the TIG and the Institute.