

(Translation)

LC: SFST's Speech in the Motion Debate on "Comprehensive Review of the Inland Revenue Ordinance"

Following is the speech by the Secretary for Financial Services and the Treasury, Mr Frederick MA, in the motion debate on "Comprehensive Review of the Inland Revenue Ordinance" in the Legislative Council today (May 11):

Madam President,

Ever since Hon TAM Heung-man joined this Council, she has proposed to conduct a comprehensive review of the Inland Revenue Ordinance (IRO) on a number of occasions. I have respect for her perseverance.

I would like to make it clear that the Government will definitely support any proposal that is feasible and in the overall interests of Hong Kong.

In response to Hon TAM Heung-man's motion, I would like to raise the following points for analysis:

Nearly 30 years since the last comprehensive review in 1976

Hon TAM Heung-man moved her motion by saying that " ... it has been nearly 30 years since the Government conducted a comprehensive review of the Inland Revenue Ordinance (IRO) in 1976 ...". She called on the Government to "expeditiously conduct a comprehensive review of the IRO." I would like to reiterate that it is incorrect to say that the IRO has not been reviewed for 30 years. In fact, it is amended almost every year. As some Members have mentioned, since 1991, 34 amendments have already been made.

The comprehensive review in 1976 that Hon TAM Heung-man often mentioned is, in fact, the approach to tax law review adopted by the Government several decades ago. Since the 1980s, we have kept the various tax items under constant review in order to cope with the ever-changing economic and social conditions. In other words, we have been reviewing our tax law regularly. Apart from encouraging the establishment of the cross-sectoral Joint Liaison Committee on Taxation (JLCT) to advise the Government on taxation

policy and tax law, we also review various tax items in the context of the annual budget exercises.

Moreover, as we all know, the Government has also conducted a number of reviews on taxation policy in recent years. In 1997-98, for instance, the Government established the Working Group on Profits Tax Review to conduct a comprehensive and in-depth review of the profits tax system. The Government has implemented a number of reforms in the profits tax system in the light of the recommendations by the Working Group. These reforms include allowing an immediate 100% write-off for new expenditure on plant and machinery specifically related to manufacturing, and on computer hardware and software; providing a concessionary tax rate for interest received from qualified debt instruments; setting up a system for the Commissioner of Inland Revenue to provide an advance ruling on taxation matters; and establishing the directions for entering into comprehensive double taxation agreements with overseas jurisdictions and the Mainland.

Besides, the Government also set up the Advisory Committee on New Broad-based Taxes in 2000 to consider what types of broad-based taxes might be suitable for introduction into Hong Kong on the principle of maintaining a simple taxation regime and preserving Hong Kong's competitiveness. We have also noted the issues raised by Hon Audrey EU Yuet-mee just now. So we have assessed a total of 13 taxation options, including those for enhancing the revenue productivity of the existing taxes as well as those for introducing new tax types.

Last year, the Government set up the Estate Duty Review Committee to consider the retention or abolition of estate duty. It also consulted the industry and the public on ways of exempting offshore funds from profits tax. Therefore, Members should be aware that the Government has been constantly reviewing the tax law. Hon KWOK Ka-ki said that it should be a very simple thing and that he saw no reason why people treated it as a great scourge. Hon TAM Heung-man said that we had to see if the provisions were clear. I would like to stress that a comprehensive review of the tax regime is not a simple exercise. It is not like dealing with the trivial problems of your companies. It will take at least a few years to complete. Moreover, this will send a wrong signal to the international and local investors that Hong Kong is going to overhaul its tax regime. This will generate long-term uncertainties in the investment environment, and will be prejudicial rather than conducive to Hong Kong's competitiveness.

I think that the Government's present approach of keeping various tax items under constant review will enable it to make timely adjustment to our taxation policy and tax regime so as to cope with the changes in economic environment and mode of business. To my knowledge, many people from the accountancy sector, including the Hong Kong Institute of

Certified Public Accountants with a membership of more than 20 000 people and the Hong Kong Branch of the Association of International Accountants, consider that in-depth studies on specific major issues would be more effective than a comprehensive review of the tax law and would better meet the actual needs of Hong Kong.

Enhancing consistency in implementation

One of the stated reasons why Hon TAM Heung-man proposed to conduct a comprehensive review of the IRO is to enhance consistency in its implementation. This, in fact, involves the administrative issue of the tax law. In order to ensure integrity and transparency in the exercise of tax-assessing duties, the Inland Revenue Department (IRD) has published a series of Departmental Interpretation and Practice Notes (DIPNs) setting out the Department's view on applications of the tax law and the usual practices in conducting the tax assessment functions based on the cases of the Board of Review, and the local and relevant overseas courts. To facilitate taxpayers' access to such information, these notes are also published on the website of the IRD. The Department also has a statutory mechanism for providing advance ruling on taxation matters. Rulings that may be of interest to the tax-paying public are published on the website. Other more important policies that may affect taxpayers, such as the policy of imposing a penalty by way of Additional Tax on tax evasion offences, are also published on the IRD website for easy reference.

Besides, our tax regime has a well-defined system of objection and appeal, which enables taxpayers to contest the judgments or assessments made by the Commissioner of Inland Revenue or the assessors. For instance, disagreements will be adjudged by the Board of Review, which is an independent statutory body established to determine tax appeals, as well as the independent courts. This mechanism provides very effective checks and balances on the discretionary power exercised by the Commissioner or other tax officials and has been operating effectively.

Making the provisions more simple and certain

Another reason for Hon TAM Heung-man to propose a comprehensive review of the IRO was that she wanted to make the provisions more simple and certain. Hon TAM Heung-man said in her speech that the tax law of Hong Kong and the rules of the game are not clear. I have reservations about what she said and hope that she can give some concrete evidence to support it. In fact, the simple tax regime is an advantage of Hong Kong and is also internationally recognised. We rank first in 2005 amongst 161 places as the freest economy in the world by 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. Certainty and simplicity in the taxation system are very important to foreign investors. Moreover, many professionals and people from the business community who have some acquaintance with the tax regimes of other places have told me that the tax regime and tax law of Hong Kong is simpler and clearer than those of other places, such as the United States. Hon Albert Jinghan CHENG and Hon Abraham SHEK Lai-him have just given high praise to our tax regime.

It perplexes me that while Hon TAM Heung-man proposes to conduct a comprehensive review of the IRO to make it more simple on one hand, she has once expressed a view that the IRD's DIPNs should be incorporated into the IRO on the other. Wouldn't such incorporation make the IRO more complicated? I have checked with the IRD. They have advised me that there are at present more than 40 DIPNs, each consisting of at least over 10 pages and some as many as 30 to 40 pages. If the DIPNs are incorporated, the IRO will become very bulky. Besides, if explanatory and practice notes are to become parts of the law, the flexibility and timeliness for refining the IRO will lessen. This will go against her intention to keep the IRO abreast with the latest developments in society. Indeed many other tax jurisdictions have adopted an approach like ours and issued practice notes similar to DIPNs instead of introducing tax legislation.

Establishing a statutory advisory body on taxation

Hon TAM Heung-man has proposed to establish a statutory advisory body on taxation. As a matter of fact, the Government has all along been consulting the industry and the public on taxation policy through various channels.

In the first place, the above-mentioned JLCT comprises representatives from the government and professional bodies, the business community and the academia as well as other people interested in taxation matters. Hon James TIEN Pei-chun has also mentioned just now that its members include representatives from the Hong Kong Institute of Certified Public Accountants, the International Fiscal Association, the Law Society of Hong Kong and chambers of commerce. JLCT holds monthly meetings, which are attended by the Commissioner of Inland Revenue and officers of the Treasury Branch on my behalf. JLCT will set up ad hoc committees and working parties to undertake in-depth studies on specific issues whenever such a need arises. In fact, the specific issues raised by Members just now will be studied by the JLCT. JLCT has proposed many constructive ideas over the years and we are deeply appreciative of its contributions.

Hon TAM Heung-man has also mentioned that the JLCT discusses technical taxation issues. I would like to take this opportunity to clarify that her understanding in this respect is incorrect. The work of the JLCT covers all taxation matters. This means that the JLCT may advise the Government on issues including taxation policy.

Furthermore, in preparing his annual Budgets, the Financial Secretary consults widely with various sectors, including all Members, and representatives from District Councils, Heung Yee Kuk, chambers of commerce, academics, tax practitioners, analysts, accountancy associations, economists as well as the labour and social welfare sectors, in order to have due regard to the views of various sectors and strata of the community. In this year, for example, the Financial Secretary, my colleagues and I have attended over 20 consultation meetings to listen to the views of different organisations and people on public finance, including taxation policy. The sectors and levels covered by such consultations are more extensive than those by any single consultative and advisory body.

Besides, as I have mentioned earlier, the Government has established ad hoc committees to carry out in-depth studies on some specific issues on taxation policy, such as the issues on profits tax, the broadening of tax base and abolition of estate duty.

In addition, the IRD and the Hong Kong Institute of Certified Public Accountants also hold meetings regularly to discuss issues of common concern. The Institute, as I have just mentioned, has over 20 000 members and has made 16 submissions on a number of taxation matters to the Government over the past four years or so. The Government has also appointed representatives from the accountancy sector to the Board of Inland Revenue and to serve on the Inland Revenue Department Users' Committee to advise on the work procedures and practices of the IRD. Moreover, the Government has invited the Institute to nominate representatives to serve on the Board of Review so that they can play a positive role in the enforcement of tax law and arbitration of tax disputes. The staff of the IRD and members of the Institute have maintained regular dialogue with staff of the taxation units in the Mainland. Several Members have just mentioned some taxation issues in relation to the Mainland to which we have paid attention. Since I took up this position, I have had over 30 meetings with different organisations and members of the accountancy profession to exchange views on issues of concern.

We consider that the existing mechanism is very effective in enabling the Government to know the views of the relevant professions, business community and other sectors on taxation policy and tax law. There is no reason to remove it and set up another one.

Amendment made by Hon LEE Cheuk-yan

In his amendment to the motion, Hon LEE Cheuk-yan suggests that the Government consider introducing a progressive profits tax system. I appreciate and respect the motive behind this suggestion, but a progressive rate system in the context of profits tax is so prone to abuse that it will not have its desired effects. Hon James TIEN Pei-chun has just mentioned that some people know how to avoid the tax, for example, by setting up a number of companies to reduce their profits tax. So, once a taxation measure is proposed, some people have already thought of ways to avoid the tax. At the same time, we should consider whether our tax system is competitive in relation to that of other countries in the world or in the region. Hon LEUNG Kwok-hung has just mentioned that the profits tax rate in Singapore is on a downward trend. What he has said is correct, for the profits tax rate in Singapore has been reduced from 30% to 20%, approaching that in Hong Kong. Some European countries are striving to turn their progressive tax systems into flat tax systems. Hon LEE Cheuk-yan must have done a lot of study in this respect as he has cited the case of Estonia. To my understanding, after Estonia has changed her tax system, eight countries in Europe have followed suit. It seems therefore that it is a global trend to adopt a flat tax rate.

In view of the above, we do not agree with the amendment made by Hon LEE Cheuk-yan.

Amendment made by Hon Patrick LAU Sau-shing

Hon Patrick LAU Sau-shing suggested that the Government study the specific issues in relation to Hong Kong's tax regime and the implementation of the IRO, with a view to enhancing Hong Kong's competitiveness and its attractiveness to international investors. We agree that a more pragmatic approach to taxation matters is to conduct systematic in-depth discussions on the specific issues of concern to the industry. This would be more effective and practical than deploying enormous manpower and resources to conduct a review of the IRO and the relevant subsidiary legislation, which runs for hundreds of pages, without any definite directions, objectives or focus. Therefore, I support Hon Patrick LAU Sau-shing's amendment to the motion.

A simple, low tax regime is the bedrock of Hong Kong's success. We should give fuller play to this hard-earned advantage by pooling our resources and energy to deal with specific taxation matters which are considered to be really important. A comprehensive review of the IRO that lacks a definite aim or focal point would only lead to spreading limited resources on administering those well-established provisions (as mentioned by Hon Abraham

SHEK Lai-him) of taxation legislation which have in fact been operating smoothly over the years, which will inevitably reduce the resources which could have been pooled to deal with taxation issues that are of concern to members of the public and should be accorded top priority. Would this be in the interests of the Hong Kong people?

My colleagues and I, of course, will seek continuous improvement and study the major issues of concern to the industry, business and trade organisations as well as the public. In fact, when Hon TAM Heung-man and members of various sectors raised their concerns on taxation matters, some Members mentioned that some of these might be administrative issues. We have forwarded those matters to the JLCT for consideration. Besides, some Members have personally raised individual taxation matters with me. We are happy to listen to their views and have arranged for colleagues of the IRD to hear them out. I would like to point out that we will continue to communicate and work closely with various sectors to see how best we can make improvement. We will also explore ways of extending the existing consultation channels to pool ideas from all sectors of the community so that we can do better in the implementation and formulation of our taxation policy. We will strive to make constant improvements and will not be complacent.

Thank you, Madam President.

Ends/Wednesday, May 11, 2005