

**THE HONG KONG GENERAL CHAMBER OF COMMERCE**

**PROPOSALS FOR THE 2010-11 BUDGET**

*A SUBMISSION TO THE HONG KONG SAR FINANCIAL SECRETARY,  
THE HON JOHN TSANG CHUN-WAH, ON THE GOVERNMENT'S  
BUDGET  
FOR THE FISCAL YEAR 2010-11  
(1 APRIL 2010 TO 31 MARCH 2011).*

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## Synopsis

In this year's submission to the Financial Secretary on the Government's Budget for the fiscal year of 2010-2011, the Hong Kong General Chamber of Commerce urges the Government to raise the territory's competitive advantages by introducing tax measures which will:

- strengthen our reputation as the premier business centre in this region which offers the lowest and best tax environment
- attract corporations to maintain or set up new headquarters in the Hong Kong
- assist small- and medium-sized enterprises along the road to recovery.

Accordingly, our key recommendations are:

### **Key Recommendation 1: Return the profits tax rate to 15% immediately**

It makes strategic sense to renew our status as the most competitive tax environment in the region. This is particularly urgent considering that our competitors are aggressively lowering their tax rates to attract businesses.

It should be noted that in the Chamber's just completed Annual Business Prospects Survey, the majority of respondents indicated that Hong Kong's competitiveness had not improved in the past year. More worryingly, 60% of those surveyed do not expect Hong Kong's competitiveness to improve in the next 3-5 years. Reducing profits tax to 15% will send a clear signal to the international business community that Hong Kong is determined to maintain its competitiveness, and the businesses which are already here that we want them to stay.

### **Key Recommendation 2: Introduce group loss relief and loss carry-back**

A transparent group loss relief regime for Hong Kong is very much in keeping with global trends. Hong Kong does not provide such tax relief, which places us at a global tax and economic disadvantage. This omission diminishes Hong Kong's attraction as a base for holding companies and discourages Hong Kong enterprises from taking risks and innovation.

### **Key Recommendation 3: Support SMEs and Encourage Industries**

The Chamber stresses that the Government must continue to provide assistance to small- and medium-sized companies to keep them viable during the prolonged recovery. We believe that a pro-active, pro-competition measure would be to establish an effective tax rate of 10% on the first \$500,000 of assessable income for SMEs. In Singapore, for example, SMEs can benefit from the partial tax exemption on the first S\$300,000 of income.

Also, for companies that purchase capital equipment for use in Mainland China, it would provide relief if Section 39E of the Inland Revenue Ordinance is amended to allow claims of tax depreciation for such equipment. Amending Section 39E will also encourage the development of technology-based industries.

### *Beyond Fiscal Measures*

Looking beyond the Budget for the next fiscal year, the Chamber is of the view that the government should not lose sight of a few important matters, all of which concerns Hong Kong's Hong Kong's connectivity with the Mainland and the world.

First, one of the most pressing tasks in front of us is to provide input to the 12<sup>th</sup> Five Year Plan, through which we should aim to position Hong Kong strategically in China's economic development. Of all the strategic development possibilities for Hong Kong, the development of Hong Kong's financial industry so as to capture opportunities arising from China's needs, maintaining Hong Kong's connectivity with the world and the further integration with the Pearl River Delta are of the highest priorities.

For example, the development of Hong Kong as an offshore RMB centre will be our unique contribution to the internationalisation of the RMB and a key move to propel Hong Kong's financial services industry to a higher plane, capturing the abundant opportunities along the way.

Second, as Hong Kong's economy still heavily depends on external trade, it is imperative that Hong Kong works proactively to maintain its regional shipping centre and entreport status, which is a challenging goal in view of China's increasing active initiative in setting up bilateral free trade agreements with its trading partners. Hong Kong needs to take into account these developments, and work with Mainland China to find ways to enable Hong Kong to benefit from the successful conclusions of these FTAs while continuing to contribute to the Mainland economy as a regional shipping centre and entreport. The recent FTA between China and ASEAN countries provides an example of how on the basis of CEPA, a "CEPA-Plus" arrangement can work for Hong Kong in seizing these opportunities and provide a model to expand it to other FTAs relevant to Hong Kong and the Mainland.

Overall, we are of the view that Hong Kong should strive to maintain its connectivity with the world in order to avoid Hong Kong gradually "falling off the map" as global focus is ever more keenly put on the domestic Chinese economy. Hong Kong's intermediary role between Mainland and the rest of the world remains critical, but we desperately need forceful messaging to remind international businesses of our role. We believe a review of the roles and functions of the Government's Economic and Trade Offices around the world is a timely move in this context.

The detailed submission follows.

## ***‘A Competitive Recovery’***

The past two years have seen the global economy suffer its worst synchronised contraction since reliable records were first compiled. The most severe financial crisis to hit the United States and Europe, simultaneously, in many decades has shattered consumer confidence in the OECD, and put paid to notions of a quick, ‘V-shaped’ recovery. The shock of lost retirement funds, lost confidence in governing institutions and household financial brand names, and yet another doubling of the price of oil have pulled the rug out from under expectations of a quick return to business as usual. Government needs to remain vigilant in providing tax measures which would sustain the competitiveness of our businesses and keep our SMEs afloat.

### **1. Reduce Profits Tax Rate:**

#### ***Strengthen Reputation as Region’s Premier Business Centre***

Our first recommendation addresses a continuing volatile economic environment in the coming year. It will probably be the most opportune time that the Administration takes the step committed in Chief Executive’s campaign pledge to return the Profits Tax rate to 15%, with immediate effect.

If the economic recovery stalls mid-year, the reduction will be an early and prudent stimulus measure. Alternatively, if we are on the cusp of a full recovery, the measure would directly address the threat to our competitiveness emerging from neighbouring economies.

This year, profits taxes in Singapore are just 17.5%, whereas those in Korea and Taiwan are being reduced to 20%. As these other economies also offer substantial incentives not available here, Hong Kong cannot afford to sit on our laurels and claim that we offer the most attractive tax environment for businesses when we are no longer as attractive as we have been in the past.

### **2. Enhance Competitiveness:**

#### ***Maintain HK’s Attractiveness to Corporate Headquarters***

Part and parcel of deciding where to locate an international business is whether one is able to predict what taxes will apply. We urge for enhance of certainty and transparency in the taxation rules for the following matters, with a view to enhance Hong Kong’s competitiveness in attracting international businesses to set up headquarters or global operations in Hong Kong, and to convince those which are already here that Hong Kong is keen to keep them.

#### **2.1 Group loss relief and loss carry-back**

Introducing group loss relief and loss carry-back is a major step to maintain Hong Kong’s attractiveness to international businesses. Our major competitor in the region, Singapore, has already implemented the change. We believe that the worry of losing some small amount of revenue is not commensurate with the value the measure can help in strengthening Hong Kong’s reputation as the best tax environment for businesses.

To alleviate the immediate financial burden of companies, especially those suffering under ‘fair value’ accounting rules, the loss carry-back measures should be introduced as soon as possible. Under ‘fair value’ accounting rule, the IRD taxes unrealized gains or losses but these gains may turn out to be losses when the underlying assets are disposed of. Without the loss-carry back provisions, an unfair situation arises when taxpayers must pay tax on profits they did not make.

We believe a three-year loss carry back would be appropriate. We are familiar with the Inland Revenue Department’s (IRD) objections, but those concerns have been faced by other jurisdictions which have this measure and they are not insurmountable. For details of our responses to the IRD’s concerns, please refer to the Appendix.

## **2.2 Enhance clarity in source-based tax system**

We remain convinced that legislative amendment to enhance certainty as to the factors to be taken into account in determining the source of different types of income is urgently needed.

Hong Kong’s source-based tax system has long been a clear and clean competitive offering, but recent court decisions – and particularly the way the IRD responded to those decisions – did not help clarify the rules for determining the source of profits, in particular trading profits. Our members tell us that IRD assessors have taken different views on the importance of certain factors, and then seek to re-assess companies as far back as six years. The uncertainties arising, if not removed promptly, are likely to harm our reputation as having a certain, simple and fair tax system.

## **2.3 Review tax reassessment period**

The IRO currently grants the IRD six years during which it may revisit tax assessments (and, where a taxpayer has tax losses, this period is unlimited). This means that taxpayers have to keep records indefinitely in order to discharge their burden of proof, even though under the Companies Ordinance and the IRO a business is only required to keep records for seven years.

The extraordinarily long period during which the IRD may revisit a case means that taxpayers who fail to retain their records may be falsely assessed over issues considered resolved many years earlier. This does not assist taxpayers in reaching a certain or final result on their Hong Kong tax affairs. The Government should consider reducing the reassessment period (or assessment of a loss making company) to three years from the date of lodging the relevant tax return.

## **2.4 Right to object to decisions in loss cases**

Companies should be allowed the right to object to decisions in loss cases. At present taxpayers have no objection right to the Statement of Loss issued by the Assessor. If a taxpayer is in dispute with the Assessor on the amount of loss for the current year, he cannot object to the Assessor’s Statement of Loss until he has assessable profits to set off the loss in future year. This creates uncertainty to the taxpayer.

In addition, as stated in 2.2 above, it will also place a heavy burden on the taxpayer to keep record for period beyond that required under Section 51C of the IRO. If the staff or director involved have left employment or passed away, the company would find it difficult, if not impossible to

defend its claim. It seems to be fair and practical to treat a 'Statement of Loss' the same as an Assessment with the same objection right and revisiting period.

## **2.5 Simplify compliance to attract global trading operations**

There has been an increasing number of Global Trading Operations set up in different industries, especially financial services. A typical Global Trading Operations set-up is made up of an international business's presence in different targeted markets playing their respective roles. Trading transactions will typically be booked at one location, e.g. London. Hong Kong, equipped with excellent telecommunication networks and international business experience, is in a good position to attract more of these operations, but our tax regime has to be simplified for us to do so.

At present, if a Global Trading Operation has a presence in Hong Kong, the entity to which profits are booked will be deemed as carrying on a business in Hong Kong. Profits attributable to the business and carried on in Hong Kong may not be subject to Profits Tax, as the 'booked' income was derived from transactions effected outside the SAR. The said entity will have to file a Hong Kong profits tax return and keep a separate set of books for its operations in Hong Kong with sufficient details to enable it to support claims that the booked profits were sourced outside of Hong Kong. We believe that this creates an unnecessary compliance burden for these businesses and will discourage them from using Hong Kong in their operations.

We suggest that such operations should be given an option to pay Hong Kong tax via a transfer pricing mechanism, under which the Hong Kong operations can charge the profit-booking centre an arms length management fee and report such fee income for Hong Kong tax purposes. By simplifying the compliance burden and providing an easily calculable tax for the Hong Kong operation, we believe that it will encourage businesses to use Hong Kong.

## **2.6 Exempt tax on income from local bond market**

At present, if a Hong Kong corporation invests its funds in bonds issued by another Hong Kong corporation, the interest income is subject to Profits Tax. Effectively, Hong Kong corporations are encouraged to park surplus funds offshore, if they wish to earn non-taxable interest income from corporate bonds. Interest income from bonds issued in Hong Kong should be exempted from profits tax by extending the Exemption Order made in June 1998 to include such interest. This will encourage the development of Hong Kong's financial services and level the playing field for companies that raise finance locally.

## **2.7 Relax interest deductibility on loans from overseas associates**

Current legislation on interest deduction discriminates against genuine borrowing from overseas shareholders and associates. The rules on deductibility of interest paid to foreign affiliates should be relaxed to encourage establishment of regional headquarters in Hong Kong.

To avoid possible abuse, it may be useful to restrict the deduction to cases where there are strong commercial grounds for this type of financing structure. We also suggest that interest paid to foreign affiliates should only be deductible if the amount is calculated at a commercial rate of interest and that the Hong Kong borrower maintains an appropriate debt-to-equity ratio.

## **2.8 Taxes on employment**

### **2.8.1 Base sourcing rule on services rendered in Hong Kong**

When bidding for employee services, cross-border businesses face the cost of taxes on employee incomes, either directly through contract agreements or indirectly. In keeping with international norms, the IRO should be amended to adopt a sourcing rule based on services rendered in Hong Kong, replacing the existing rule of taxing an employee based on whether he has a Hong Kong employment (which may have little correlation with the place of performance of his services).

The ‘three factors’, as clarified in the revised DIPN 10, are the main considerations in determining the source of employment income. The IRD has acknowledged that the three factors cannot be the sole factors taken into account and in accordance with current case law, the IRD has to consider the overall ‘totality of facts.’ In essence, the revised DIPN 10 has put into writing the ‘totality of facts’ approach adopted by individual assessors, but it appears to be inconsistent with the emphasis on the three factors only in the old DIPN 10.

The totality approach inevitably results in disputes between IRD and the taxpayers on the weights to be attached to each factor in determining whether a Hong Kong employment exists. The lack of clarity and consistency is damaging. It creates uncertainty in forecasting the tax liabilities of individuals and can impede and complicate their transfer to Hong Kong.

In addition, where an employer will bear the salaries tax cost, there are doubts as to what that ultimate cost will be. This again complicates planning. Given the needs of Hong Kong's service economy and the importance of facilitating movement of individuals, unnecessary restrictions should be removed. As the IRD is handicapped by case law, the only remedy is to amend the IRO.

### **2.8.2 Pro rate salaries taxes automatically**

The IRD should automatically pro rate salaries tax for employees working outside Hong Kong for long periods (e.g. 60 days each year).

### **2.8.3 Clarify tax-deductibility of share-based compensation**

Hong Kong Financial Reporting Standard 2 requires, as of 2005, the cost inherent in share-based compensation be measured and recognized in the profit and loss account when share options and awards are granted. The IRD should publish official guidelines to clarify when and whether such expenses would be deductible (in addition to the frequently asked Q&A published on its web site).

### **2.8.4 Reform taxation of share-based compensation**

Some jurisdictions have relaxed the timing of taxing income from share-based compensation. Singapore, for example, allows employees to defer payment of tax on employee stock option plans or stock awards income for up to five years, subject to interest, and tax exemption in certain cases. The Government should consider similar measures to assist corporations in attracting and retaining high calibre employees.



### **3. Assist SMEs**

The resilience with which our SMEs have weathered the storm thus far surprised even those of us who have long championed the flexibility these companies exhibit. Yet, our members tell us that the cost of doing business here is still very high, and that they face pressing cash-flow constraints to expansion and, with it, new hiring. In this regard, we urge for a range of measures to assist SMEs to remain viable and continue to provide the employment backbone we need.

#### **3.1 Lower SME tax rate**

A proactive, pro-competition step would be to establish an effective tax rate of 10% on the first \$500,000 of assessable income. In Singapore, for example, SMEs can benefit from the partial tax exemption on the first S\$300,000 of income. Some SMEs in Mainland China, such as those with RMB10-30 million in capital and 80-100 employees, would qualify for a 20% tax rate.

Over the longer term, a greatly simplified tax administration system for SMEs will encourage innovation and entrepreneurship. As is the case for salaries taxes, we envisage a very simple profits tax return document to be filed by SMEs. At present, the only tax concession afforded to a 'small corporation' (defined as one whose gross income does not exceed \$500,000) is that it does not need to attach certain documentation to its annual tax return; but it is still required to prepare and retain such documents, for submission at a later date if required. The Government should consider not requiring audited accounts, or accepting certified management accounts, instead.

#### **3.2 Longer lead time for paying final profits taxes**

In asking for a longer lead time to pay the final tax, we are seeking to encourage companies to expand early in the recovery, and (if we do face another deep decline) to protect those who continue to struggle with depressed demand in our key markets. Because of the sharp penalties facing those who misgauge their tax liability, the oft-heard claim that companies may request a reassessment rings hollow.

#### **3.3 Depreciation allowance for restoration expenses**

In the area of tax deductions that are of particular importance to SMEs, we ask for consideration of measures that would give smaller companies a fair break on investments made to generate taxable profits. A case in point is the depreciation allowance for restoration expenses.

Very often, under the terms of a lease, the tenant is required to restore the premises back to the original position when the lease expires. For tax purposes, the restoration expenses are capital in nature, not deductible under Section 17(1)(c) of the IRO.

In addition, as the taxpayer is not entitled to any interest in the structure restored, no tax depreciation allowance is granted. As restoration requirement is a standard term in lease agreements and the expenses are sometimes quite substantial, it is time for the Government to consider allowing deduction on such expenditure.

### **3.4 Tax depreciation allowances of buildings and structure**

At present, no Industrial Building Allowance (IBA) and Commercial Building Allowance (CBA) is granted to a new owner if the allowances for that building have already been granted for 25 years. This is unfair to the new owners who incur substantial amount of money for the acquisition of the buildings without any allowances.

IBA and CBA are granted based on the original cost of construction. With inflation, the cost of construction of an old building is much less than that for a new one. Thus for the same price paid, a taxpayer will get less tax allowances on an old building. To rectify the unfair situations, the allowances should be based on the capital cost incurred without any age limit of the property as in the case of plant and machinery, instead of the original construction cost with a limit of 25 years.

### **3.5 Deductions for capital investments in intangibles**

Countries such as Singapore have recently introduced changes to provide for tax deduction or tax depreciation of certain capital expenditure which would otherwise be non-deductible and non-depreciable, including:

- Permitting a five-year write down allowance (equivalent to a five-year straight line tax depreciation) for expenditure incurred on the acquisition of the Indefeasible Rights of Use (IRUs) of international submarine cable systems
- Acquisition of a broad range of intellectual property rights including trade marks (Hong Kong restricts the deduction to patents and know-how)

The Government is urged to consider similar measures for Hong Kong.

## **4. Encouraging Industries**

The Government should update the IRO to permit tax deduction or tax depreciation of certain capital expenditure, in order to encourage the development of technology-based and other high value-added industries in Hong Kong, and to keep up with new ways of doing business.

### **4.1 Tax depreciation for capital equipment used outside Hong Kong**

Many Hong Kong companies purchase plant and machinery (P&M) and make them available to manufacturers in Mainland China at no charge to the latter. Under the IRO, the P&M involved in such an arrangement is regarded as 'leased'. Companies are not entitled to claim any tax depreciation because the equipment is used wholly or principally outside Hong Kong (Section 39E). IRD's Departmental Interpretation and Practice Note (DIPN) No. 15 issued in January 2006 provides a concession for contract processing cases, but not for subcontracted manufacturing.

When P&M are regarded as being contributed *in specie* to the Mainland manufacturers, companies are also denied any tax depreciation claim in Hong Kong as they no longer own and have in use the equipment (Section 37). It is not reasonable that where a Hong Kong company buys goods from a separate factory in the Mainland, and makes P&M available at no charge to the Mainland

factory as a condition of the purchase, or in return for a lower purchase price, the Hong Kong company cannot claim depreciation allowances on the P&M, even though the IRD taxes the profits from the sale of the goods manufactured with that P&M.

The Government has refused to relax the restriction on the ground that it is a complicated matter involving various issues, including: whether the machinery or plant used in the Mainland is producing profits chargeable to tax in Hong Kong; whether it is used for the manufacturing of goods sold solely to the Hong Kong enterprise; whether the P&M has been sold; whether depreciation allowances of the same P&M have been claimed by other enterprises; etc.

We believe the IRD's concerns can be resolved as they relate to factual matters, and supporting proof can be provided by the taxpayer. Moreover, under the Double Taxation Arrangement with the Mainland, Hong Kong authorities may seek information from their Mainland counterparts for verification. We are convinced such an unfair situation created by Section 39E – clearly not intended by lawmakers when the legislation was passed – should be corrected.

The Chamber advocates either one of the following solutions:

- extension of the same concession for contract processing cases to subcontracted manufacturing arrangement, or
- special deduction on the loss incurred on contributing the equipment at no charge to the Mainland Chinese factories.

## **4.2 Tourism**

Capital expenditure incurred by hotels and restaurants on decoration and refurbishment has a direct impact on the quality of tourism services. At present, expenditure incurred on renovation and refurbishment is allowed for deduction in five consecutive years in equal instalments. But five years is too long considering the wear and tear. We recommend either of the following changes:

- The number of years allowed for deduction be reduced to three years, or
- 100% immediate write-off of refurbishment costs be allowed.

## **4.3 Arts and Culture**

The potential for private sponsorship of both sports and the arts is largely untapped. Policy change such as a matching grant system would be a positive step towards tapping in the potential. Another would be to enhance the tax deductions available to corporations for contributions relating to sports, arts and cultural sponsorships. A new approach to corporate sponsorship is likely to yield a multiplication of benefits without much additional pressure on the public purse.

The Chamber believes that the best way of achieving the Culture and Heritage Commission's vision of 'Diversity with Identity' is to entrust the operation of our cultural and art resources to the community, and corporatize functions such as management of performance venues, museums and libraries where appropriate. The Government should reduce its managerial involvement in culture and art, while maintaining its financial backing. This is the best means of promoting a vibrant cultural scene and a wealth of heritage that befits a world-class city.

## **5. Environmental Concerns**

### **5.1 Polluter Pays Taxes**

We would urge the Government to consider to what extent environmental problems can be dealt with through taxes. A task force should be appointed to study policies in jurisdictions like Europe, where green taxes amount to about 8% of total taxes and social contributions collected by Government. Specific measures should be proposed based on the ‘polluter pays’ principle.

By the same principle, we should also avoid discouraging positive behaviour. Lowering or eliminating the tax on ultra low sulphur diesel fuel would not only encourage drivers to switch away from dirtier fuels, but also contribute to reducing air pollution. In principle, measures taken to change unsustainable behaviour through taxation should be revenue neutral. By that, we mean that any income should be spent specifically on addressing environmental concerns.

### **5.2 Reduce road-side emissions**

Poor air quality continues to be of major concern to the business community, and there are increasing calls for the decisive Government actions to tackle the problem. While we need to work Guangdong to address the regional dimension of the issue, we expect the Government to step up efforts locally, such as reducing road-side emissions. The Government should consider measures to support the transport industry in switching to environmentally friendly vehicles, covering both buses and commercial vehicles. Incentives such as funding support for switching should be considered to accelerate the switching process.

## **6. Toward a Transformational Fiscal Policy**

### **6.1 Independent review of IRO**

We believe it is necessary to take a new approach to fiscal policy, one that is not overly concerned with revenues. While we respect the professionalism of IRD officials, we feel that it is time to consider establishing an independent review commission to undertake a long-term, strategic review of the needs and objectives of our taxation system, and to examine specific issues related to the IRO. Such a commission should focus on recommending specific changes to the Ordinance that will improve its fairness, certainty and consistency.

### **6.2 Office of Tax Policy**

Lack of clarity is detrimental to the planning of business investments, as a clear forecast of the likely tax cost is often a deciding factor in relation to where to locate a business. Income tax uncertainties can also come as an unwelcome surprise to investors who may initially view Hong Kong’s tax system in a positive light. Such uncertainties hamper our competitiveness and thereby economic development.

The Chamber believes that a review of the IRO, combined with the establishment of an Office of Tax Policy, would help improve our competitiveness.

### **6.3 Invest in competitiveness**

For many years, we have supported the notion that our fiscal reserves are needed to tide us over in the unlikely event of a severe economic or financial shock. Hundreds of billions of dollars of taxpayer money is tied up in fiscal reserves, just in case the funds were suddenly needed to rescue the economy. Yet, despite the recent historic economic and financial crisis, we find ourselves already on the road to recovery, without having had to tap in the reserves.

We note the game-changing investments made by prior administrations, particularly in funding housing and medical care since the 1950s, we strongly urge a similar transformational investment in Hong Kong's competitiveness.

## **7. Beyond the 2010-2011 Budget**

In addition to making recommendations on the Budget for the next fiscal year, the Chamber would also like to share its thoughts in the following on some major matters concerning the longer term competitiveness and economic development of Hong Kong.

### **7.1 Development of the Financial Industry**

As the Central Government is putting together the 12th Five Year Plan, Hong Kong should position itself strategically by playing its unique role in three important aspects of development of the financial industry, namely Hong Kong's development as a wealth management centre, a major capital market and an offshore RMB centre. All three strategic moves will provide immense value in assisting China's development while at the same time benefit Hong Kong economically.

#### **7.1.1 Wealth management centre**

The Mainland's booming economy has generated a huge demand for investment products and wealth management services. Given our geographical, cultural and linguistic links, as well as our knowledge of and close relationship with the Mainland, Hong Kong is well-equipped to serve as the preferred asset and wealth management centre for the Mainland in the long run. We must grasp this opportunity and make good use of our strengths to develop Hong Kong into the premier wealth management centre in the region.

To further promote the development of the fund management industry in Hong Kong, the Government has to maintain a regulatory structure with which industry players will be able to develop a wider variety of funds and investment strategies to enhance Hong Kong's position as wealth management centre.

Trust is also part and parcel of wealth management. With the recent review of the Company Ordinance and the Trustee Ordinance, Hong Kong can strengthen itself to make it more user-friendly for high-net-worth individuals to administer their trusts in Hong Kong.

As for the development of the bond market, the Government has already pressed ahead with a HK\$100 billion Government Bond Programme. It is hoped that the programme can help broaden

and deepen our bond market, which will in turn give both fund-raisers and investors another option in the event of any financial stress in the future.

### **7.1.2 Major capital market**

With the rising domestic consumption in the Mainland, Mainland companies increasingly turn to the capital markets to fund their growth. As more Mainland enterprises are interested in raising foreign capital or gaining exposure to international standards and practices under the “going out” policy, Hong Kong should continue to strengthen itself as the capital hub for IPO and post-IPO activities from Mainland enterprises as well as overseas enterprises, especially those with businesses in the Mainland.

The financial industry has benefited from the liberalisation measures under the Closer Economic Partnership Arrangement (CEPA). For example, Mainland brokerage firms can now set up branch offices in Hong Kong, while qualified Mainland and Hong Kong securities companies will also be able to set up joint venture securities investment advisory companies in Guangdong.

In light of these developments, Hong Kong should continue to make use of CEPA to lower the threshold for Hong Kong financial institutions and financial services practitioners to enter the Mainland market. On the other hand, in order to play our role effectively as the testing ground and bridgehead of the Mainland’s financial development and innovation, Hong Kong should continue to leverage on the “early and pilot implementation” policy to enhance the two-way flow of financial institutions, financial products, capital and talents between Hong Kong and the Pearl River Delta Region.

### **7.1.3 Offshore RMB centre**

The Central Government is expecting Hong Kong to play an important role in contributing to the internationalization of the RMB. Developing offshore RMB business in Hong Kong will serve two important goals at the same time. First, it will contribute to the internationalization process of the RMB. At the same time developing RMB business in Hong Kong will help build Hong Kong into a regional wealth management centre.

The Chamber has been advocating that Hong Kong should focus on developing into a regional wealth management centre in order to capture opportunities arising from wealth recreation in Mainland China. This is our unique strength and competitive advantage.

For Hong Kong to develop into a major RMB offshore centre, it is imperative to quickly build up a critical mass of RMB business in the city. We would urge that the Government should work with the Mainland authorities and Hong Kong’s financial sector to explore new RMB-related products and services as quickly as possible.

We are aware that there have been different views about where the biggest potential lies. For example, some say while RMB trade finance will be in demand, the real opportunities are with developing investment products: bonds, derivatives, funds and even insurance products. We think it makes a lot of sense to focus on developing investment products, so as to tie in with the wealth management centre development.

## **7.2 Strengthening Hong Kong's connectivity with the world and "CEPA-Plus"**

As the Chamber found out in a recent visit to Washington, D.C., the danger is considerable that Hong Kong will "fall off the map" as the world's focus is ever more keenly put on the domestic Chinese economy.

Hong Kong's intermediary role between Mainland businesses and companies around the world remains critical in facilitating China's "going out" policies, but without forceful messaging to remind international businesses of this critical role, false perceptions may develop that will help neither Hong Kong nor China. A review of the size and function of our Economic and Trade Offices around the world may have considerable value.

As a matter of immediate priority, we believe Hong Kong should capitalise on the historically important role it has played in facilitating multilateral trade discussions by playing a proactive role in driving the Doha Round to a successful conclusion. On the foundations of the highly successful MC6 Ministerial meeting held in Hong Kong in December 2005, the HKSAR Government is well placed to use such an opportunity to demonstrate Hong Kong's continuing importance, and its distinctiveness. The Chamber has made its own contribution in this regard by sending a delegation to the World Coalition of Services Industry Summit in Washington, D.C., last October.

On the other hand, as China is expected to continue engaging in the region's trade liberalization and enter into more bilateral free trade agreements, the Chamber would advocate promoting a "CEPA-plus" model, through which Hong Kong may continue to play its unique role as a regional shipping centre and entreport facilitating bilateral trade between the Mainland and other economies in the region.

It should be recalled that, upon the recommendation of the Chamber in 2006, the Government has taken note of the importance of not losing sight on the potentially huge impact on Hong Kong as a result of the China-ASEAN Free Trade Agreement. The Central Government has agreed to the proposal from Hong Kong that, under the China-ASEAN FTA, ASEAN goods transported to the Mainland through Hong Kong would also be considered "direct consignment" for the purposes of customs declaration, provided that the goods have been verified and confirmed in Hong Kong to be transshipment without involvement in trading in other areas. Such arrangement preserves Hong Kong's important role without affecting the interests of China and ASEAN countries.

Having established this precedent, the Chamber is of the view that the Government should continue to make use of this model in engaging with the Central Government over other FTAs signed between China and its trading partners: a "CEPA-plus" model of incorporating Hong Kong into China's bilateral FTA regime. This is fully in line with the Central Government's agreement that if a free trade agreement signed between China and another economy contains commitments that are more favourable than CEPA's, they will be incorporated in the liberalisation programmes under CEPA.

To enable the CEPA-plus model to continue serve Hong Kong's interests, the Hong Kong Government must proactively engage with the relevant ministries of the Central Government and, where appropriate, enhance understanding through communications with China's trading partners. The chamber stands by to support the Government's efforts in this regard.

### **7.3 Integration with PRD**

The 12th Five Year Plan also relates to us in terms of Hong Kong's integration with the Pearl River Delta. The integration of Hong Kong and the PRD is already part of the national development strategy and Hong Kong is obliged to play its role in implementing the strategy, on the basis of making use and further development of CEPA, as well as physical infrastructural linkages.

It is in the context of integration with PRD that the Chamber sees the strategic value of developing the six new pillar industries identified by the Government. We would urge that the focus be put on how the six industries should be developed by tapping in the potential of the PRD market, leveraging the respective strengths of both sides, and serving each other's needs. One such possibility is the development of a "circular economy" in which recycling is systematically maximised, and pollution and waste minimised. The Chamber notes major initiatives being undertaken in this area by the Central Government as part of its national stimulus initiative - both to encourage and assist upgrading to new and more energy efficient domestic appliances, and to ensure that disposed items are comprehensively recycled - and believes Hong Kong can and should play a significant role in shaping and driving those initiatives, in particular in cooperation with the PRD.

January 2010  
Hong Kong



## **Appendix**

### **Group Loss Relief and Loss Carry-Back**

#### **- The Chamber's responses to IRD's main concerns**

Upon closer examination, the problems often cited by the Government for not introducing such tax relief do not appear to be valid. Where legitimate concerns are raised, there are measures that can be taken to resolve them. The objections are fourfold:

(1) Group loss relief will encourage tax avoidance

Chamber response:

On the contrary, it is likely that such a measure will actually assist the IRD in improving its tax collection. The IRD will be able to collate information regarding a group for the first time, and such information will assist in the enforcement of the IRO.

(2) Group loss relief will lead to revenue loss

Chamber response:

Hong Kong's \$455 billion fiscal reserves only declined by less than 6% last year, when we experienced the worst financial and economic turmoil in many decades. When Australia and Singapore introduced loss relief, they estimated the loss in revenue to be in the order of a few percent of the total tax collections. The actual cost may be lower or higher as it is difficult to estimate the real impact of this measure. However, it will be offset by the improved enforcement as a result of a better understanding of the group companies and related party transactions, and increases in competitiveness which will lead to an increase in businesses being set up in Hong Kong, and ultimately, taxpayers.

(3) Tax law is too complex to incorporate group loss relief

Chamber response:

It is true that certain types of loss relief measures such as a consolidation regime can be complex. However, the group loss transfer system such as the one adopted by UK and Singapore is relatively simple. Singapore only added one section (Section 37C) to the Singapore Income Tax Act when it introduced the group loss transfer system. Under that section, a fellow group company may elect to transfer its loss to another group company by adding only one line to its tax computation.

(4) Further anti-avoidance provisions are needed

Chamber response:

Singapore did not deem it necessary to enhance its own anti-avoidance legislation and, to the best of our knowledge, have not had to resort to application of even the existing regulations to any taxpayer.