香港董事學會
The Hong Kong Institute of Directors

20 February 2013

The Hon Tsang Chun Wah John GBM JP
Financial Secretary
The Financial Secretary's Office
25/F, Central Government Offices
2 Tim Mei Avenue
Tamar, Hong Kong

Dear Mr Tsang

HKIoD's Recommendations for the 2013-14 Budget

The Hong Kong Institute of Directors ("HKIoD") is pleased to forward our views for your consideration in preparing the 2013-2014 Budget.

HKIoD is Hong Kong's premier body representing professional directors working together to promote good corporate governance. We are committed to promoting director professionalism and good corporate governance, as well as contributing towards the formulation of public policies that are conducive to the advancement of Hong Kong's international status.

In relation to the 2013-2014 Budget, we have consulted members and conducted focused review by our Economics & Public Affairs Committee under the chairmanship of Prof Christopher To. Hence, the response represents our consolidated views.

Should you require further information regarding our submission, we will be pleased to meet and discuss with you at your convenience.

Thank you very much for your kind attention.

Yours sincerely
THE HONG KONG INSTITUTE OF DIRECTORS

Dr Carlye Tsui

Enc

cc: Dr Kelvin Wong, Chairman, HKIoD
Prof Christopher To, Council Member, HKIoD &
Chairman, Economics and Public Affairs Committee

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HKIoD's recommendations for Government Budget 2013-14

The Hong Kong Institute of Directors ("HKIoD") is pleased to submit its views on the Government Budget for the 2013-14 year.

Fiscal policy and budget to meet Hong Kong needs

If the Policy Address is blue print in hand, it is now a matter of implementation. If the Policy Address sets the direction, we now need budget measures to take us there.

The need for fiscal prudence must be put in the context of our need to invest in Hong Kong's future development and to solve the imminent problems facing us. We will need new and additional infrastructure to make headway for development. We will need to prepare for an ageing population. As we stated in our recommendations for the recent Policy Address, fiscal policy and budget management must comport with development needs. Economic strength is our best friend for new monies to solve livelihood issues.

Fiscal reserves in vast quantity are a gift to Hong Kong. They can be and should be better deployed, to generate earnings that support our social expenditure now and in future, to invest in infrastructure, and to be seed monies for new industries in our economic development.

Appropriate tax incentives and concessions have the effect of channeling investments into areas of the economy we want to develop, and of shaping and changing behavior towards alleviating some of our livelihood, welfare and environmental issues.

Economic development – a tax system to support development

Refresh our tax system to keep us competitive

The availability of tax incentives and concessions has the effect of lowering the effective tax rates for businesses. This is an important factor for investment decisions. Our neighbouring jurisdictions are all competing with Hong Kong for investments, and they offer tax incentives and concessions in many forms and shapes to do so. This has dulled so much the Hong Kong tax system's competitive edge. We repeat our call on the Government to review the tax regime and to add or augment tax incentives to better match business needs, to spur development.

Tax administration

Headline tax rate is but one aspect of our tax system's competitiveness. A tax regime with rules clearly understood and interpretations consistently applied will enable taxpayers to better plan their activities. That will be a tax regime that lowers compliance costs and burden in the long run. Tax administration is just as important, perhaps more so than low headline rate, to make the Hong Kong tax system competitive.

We repeat our recommendation to accord an IRD "statement of loss" the same status of a "notice of assessment". We further recommend shortening the time bar period for re-opening a case not involving fraud or similar egregious acts. Taxpayers should not be asked to carry an uncertainty of not having their loss status confirmed and to bear a definite burden of having to keep records indefinitely.

Hong Kong raced to enter into a number of double tax agreements in the past few years to shed its perceived image of being a tax haven. The effort deserves commending. But these treaties have left considerable implementation details to be hashed out, especially as regards to issues that invoke the interaction of treaty provisions and the local tax rules. Taxpayers should be able to tap the benefits that the various tax treaties promise. Going forward, we think the focus is not so much to sign many more new treaties but to conclude treaties with the bigger major trade partners. Implementation details in respect of treaties already signed should also be a priority.

Tax rules and tax administration must also catch up with time and development. With fair value accounting is a move away from realization basis of taxation to assessing fair value gains on financial instruments that have not been realized. The tax rules, however, as yet do not recognize a carry back of losses to offset the tax assessed on unrealized gains in earlier years. We repeat our call on the Government to introduce loss carry-back.

The case for a tax policy unit

Demands of global economy and new realities stemming from evolving accounting standards should warrant not expedient and patchwork fixes, but strategic and holistic look at the tax rules to be sure they keep pace with developments and are attuned to how business is conducted in practice. There is a strong argument for and a practical need to have a high-level tax policy unit outside of the Inland Revenue Department to formulate tax policy that make us competitive. Separate the role of tax collector and tax policy-maker.

Tax incentives to support development

We recommend measures and incentives to support development in several areas:

- For asset management: We will support initiatives and measures to further develop Hong Kong as the choice domicile for asset management, to develop commodities trading in Hong Kong, and to push further Hong Kong's ability and attractiveness to be the domicile for captive insurance management.

- For Hong Kong to become choice location for regional headquarters: If Hong Kong can reinforce its attractiveness as a choice location for regional headquarters or holding companies of business enterprises, it will draw and retain a strong pool of talents with responsibility to manage and direct company affairs. It will also attract experienced personnel from various professional services to Hong Kong. This will benefit the long term economic development of Hong Kong.

    - Group loss relief: To support this development, we propose the introduction of "group loss relief", to be available only to wholly-owned and near wholly-owned subsidiaries of the same group of companies.
    - Concessionary rate: We also propose concessionary tax rates for income earned by regional headquarters for management and consultancy services provided to associated entities.
    - Interest deduction: We also propose that interest income received by regional headquarters from loans made to their associates be exempted from taxation. Likewise, interest paid by regional headquarters should also be deductible.

- For a creative economy: An attractive R&D rebate scheme and generous tax deductions for costs on R&D and acquisition of intellectual property rights will provide strong incentives for businesses to develop or acquire innovative technology to benefit many of our industry sectors, including the nascent testing and certification services and the environmental industries. These are some essential measures to help build our knowledge-based economy and make Hong Kong an intellectual property hub.

    - R&D rebate: We suggest an increase of the current rebate rate of 10% to 20% or higher.
    - R&D costs super deduction: We further recommend a profits tax deduction of 200% or higher of R&D costs incurred by Hong Kong taxpayers. That should also cover R&D activities conducted outside Hong Kong but evidently at the direction and control of the Hong Kong taxpayer.
    - Concessions on royalty income: The Government may also consider granting a concessionary tax rate, up to full exemption, on royalty income derived from the licensing of intellectual property rights owned by a Hong Kong taxpayer for use outside Hong Kong, especially when the intellectual property rights are resulting from the taxpayer's R&D activities.

Economic development - support the SMEs

Profits tax concessions for SMEs

We recommend a waiver of profits tax on some part of assessable profits, e.g., the first HK$500,000 or higher. In the alternative or as a supplemental measure, we also recommend a reduced corporate profits tax rate for businesses whose gross income is less than a certain threshold, e.g., HK$2 million or higher.

Support SMEs with financing assistance

We are for the Chief Executive's ideas to support SMEs with financing assistance, such as microfinance schemes and long-term financing options. We look forward to further measures in this regard.

Redress the disparity in tax treatment
between "contract processing" and "import processing" arrangements

Increasingly, Mainland manufacturing operations by Hong Kong entities are switching from the "contract processing" type into "import processing" type arrangements. A change in Mainland's economic regulatory policy has had the effect of encouraging Hong Kong manufacturers to upgrade their Mainland manufacturing operations and transform them into "import processing" arrangements. The Hong Kong tax treatment for "import processing" arrangements, however, is unfavourable. This, as the HKIoD has noted before, has thrown up a serious obstacle to Hong Kong manufacturing enterprises, many of whom are SMEs, in their effort to upgrade their business operations to better tap into the Mainland domestic market.

Hong Kong needs to rectify the disparity between "contract processing" and "import processing". Our view is:-

- for Mainland manufacturing operations conducted by Hong Kong entities that are in substance "contract processing" in nature, then, regardless of the actual legal form of the arrangement, they should continue to be permitted the 50:50 apportionment of profits;

- for arrangements that cannot for one reason or another qualify themselves for the 50:50 apportionment, they should not be dealt a double blow, as in the current practice, by denying them a claim on depreciation on the plant and machinery used in the manufacturing processes. There should be appropriate law or rule changes to exclude the application of Section 39E of the Inland Revenue Ordinance to the plant and machinery used in the production of goods under processing trade arrangements.

Economic development – the right talents for success

Shape the workforce for the future economy

At the moment, we have a mismatch in the labour market, with many people looking for work while many job vacancies are on the market waiting to be filled. The structure of our workforce it now stands require prompt actions to redress, else our productivity sinks further. The structure of our workforce over time will determine how competitive we can become in the race for economic development, and ultimately how successful we can be at keeping Hong Kong a pleasant livable place.

With many infrastructural projects still in the pipeline and more homebuilding to begin over the coming years, we ought to encourage more youngsters to become a new generation of builders with modern construction skills. With hospitals short-staffed, we cannot wait longer to train new classes of nursing professionals. If we are to effectuate the avowed policy of aging at home, we would want more people with the right training and the commitment to work in the home care industry that will evolve.

We have to make strides to shape the workforce for the future economy, and we need fiscal measures to go with it.

Help people get education and training for better jobs

On top of a sustained commitment in public expenditure on general education, we recommend the following:-

- <u>Assistance in continuing education</u>: We propose that the current once a lifetime, HK$10,000 maximum subsidy for continuing education be transformed into a financial support from the Government to help those pursuing continuing education make interest payments on study loans that they obtain from financial institutions. We also propose a further tax deduction on the amounts paid as interest on the study loans. To encourage financial institutions to provide study loans to those who want to pursue continuing education, we also propose a guarantee scheme to support the study loan applications.

  We also ask the Government to consider a further increase of the self-education expense deduction allowance from the current HK$60,000 to HK$80,000 or higher. The Government may consider deeming the interest paid in respect of the study loans contemplated in the above proposal as self-education expense eligible for deduction. We also propose that, in appropriate cases, taxpayers be allowed to carry forward such interest paid for purpose of deduction.

  In the alternative or as a supplemental measure, we propose that the restrictions and conditions for the current once a lifetime, HK$10,000 maximum subsidy for continuing education be re-examined. We also ask the Government to increase the lifetime cap or, as an alternative, introduce a rolling cap for the amounts of subsidy available to an applicant so that the scheme can be made more flexible and accessible.

- Attainment of professional qualifications and vocational credentials: We propose a tax deduction for individual taxpayers on expenses associated with the attainment of professional qualifications and vocational credentials (including, in appropriate context, language training). This will help produce workers with requisite professional knowledge, qualifications and accreditation to serve the needs of Hong Kong. To prevent abuse, the Government can consider introducing appropriate caps for such deductions.

Corporate governance training

HKIoD believes lifelong training for directors in corporate governance knowledge and skills is an important yet often neglected segment when it comes to nurturing talents for the economic development of Hong Kong. The HKIoD has long supported the promotion of corporate governance training. Directors should remain up-to-date with best corporate governance practices, which are crucial to the long-term survival of their businesses and also the health and growth of the economy.

Many SMEs are not able to take full advantage of loan schemes of one kind or another. There are a number of reasons for this, but one common impediment is that many SMEs could not demonstrate proper internal control and are ill-prepared to submit sound loan proposals. A better corporate governance scorecard will make it more likely for a business to obtain credit and financing.

We recommend provisions be made to require or otherwise encourage owners and directors of SMEs to obtain training to enhance their corporate governance practices. Alternatively, the Government can consider allowing profits tax deductions (for corporate or unincorporated businesses alike) on all expenses (whether revenue or capital in nature) for recognised training activities in corporate governance subject matters.

Livelihood – relief for the squeezed and the disadvantaged

The HKIoD believes we must rely less on handing out welfare but more on giving people the ability and means to construct their future. But HKIoD agrees that public resources should be used in appropriate circumstances to help the disadvantaged groups and other people in need.

With the reversal of an estimated budget deficit into what is now expected to be a massive surplus, we can observe strong currents in the community calling for another round of one-off reliefs. We are not in favour of another round of cash handouts. We would rather see the surplus being spent on solutions for our development needs. We recommend targeted assistance, with the caution again that many forms of one-off reliefs have the undesirable effect of leaving out those most in need because they simply don’t qualify.

We have reservations about granting across the board electricity charges subsidy again. Despite increases in tariffs, we believe the electricity charges are still low relative to the affordability of many, and the tariff scales are not sufficiently progressive to encourage energy conservation.

Tax relief for middle class families

HKIoD members will support one-off rebates of salaries tax for 2012-13, subject to an appropriate cap. We also recommend appropriate widening of the tax bands in salaries tax assessment, to relieve the tax burden on the middle class.

As for salaries tax deduction allowances:-

- Healthcare: We recommend tax deduction allowance for purchase of private health care insurance;

- Retirement savings: We recommend tax deduction allowance for voluntary MPF contributions;

- Housing: We recommend an augmentation of the home loan interest deduction, first to lengthen its eligible time from the current 15, and then to make rental expenditure also eligible;

- Care for dependents: We recommend increases in both parent/grandparent allowances and child allowances, and to relax on the “ordinarily reside in Hong Kong” requirement for the former;

- Charitable contribution: We recommend raising the ceiling for assessable income against which tax deductions can be made, up to dollar-for-dollar deduction for all actual contributions made.

Livelihood – a pleasant livable place

Garbage … what to do with our garbage?

If we are to institute a levy on garbage disposal that is fair, we must first have in place the infrastructure to segregate waste at the source and to make better use of the recyclables. We need better incentives for residential and commercial buildings to reduce waste and keep recyclable materials off our landfills. We also have to stop discarded electronic products from causing more damage to our land. We should also have plans to introduce advanced incineration and other waste disposal technologies.

Better technology for a better environment
The Government can take broad steps to penalise producers of pollution and waste and to create market demand for technology and services to reduce pollution and waste. We believe this can be achieved by appropriate fees and assessments on producers, on the one hand. We also believe, on the other hand, there should be appropriate incentives to encourage the use of earth-friendly equipment or for R&D on environmental technology. For example:-

- Super deduction: We recommend a super deduction of 150% or higher on expenses for the acquisition of eligible environmental facilities;

- Tax holidays: We recommend tax holidays to taxpayers in waste management, recycling and resource recovery businesses, to encourage them to up their product offerings and service capabilities.

Of cars and air quality
If too many cars are the cause of road congestion and poor roadside air quality, introduce road pricing in congested zones;

Public transport and the commute
We believe strategic placement of transfer points, a better transfer fare mechanism and the wider adoption of monthly and weekly travel pass across different public transport service platforms will be an integral part of a larger public transport solution for those who need to make long commute to get to work.

Solve present problems, invest for the future, develop the bond market for real
The Government may be pondering another round of i-Bond offerings. Giving investors more choices for inflation protection is probably one reason. Developing the bond market may be another.

Government bonds and the bond market can probably take on a bigger role as we solve present problems and invest for the future. It is conceivable that we sell bonds to finance new infrastructure projects, knowing that (and despite) we have fiscal reserves to fall back on. The reason is, for one, to further develop our bond market. For so long as these projects have the ability to generate toll revenue over an appreciably long service life, there will be a credible ability to meet the obligations on these bonds. Monies will be necessary to redeem the instruments at maturity, but that will only come in tranches, dampening the fear of having to spend too large a sum in one shot.

Government bonds could be the means to finance high price tag solutions to some of our social problems. Take traffic congestion in cross harbor tunnels as example. We have previously advocated that the Government should present firm plans to even out the traffic among the three cross harbor tunnels. We view this less as an issue of insufficient capacity to meet cross harbor traffic demand, but more an issue of an uneven distribution of traffic due to wrong pricing incentives. It is conceivable that we can sell bonds to raise the war chest required to re-acquire the interests in the tunnels to better manage usage and traffic flow.

These bonds should have a variety of tranches, with a significant quantity with tenors 10 years or longer to create market depth. These bonds could also be marketed as income products suitable for retirement savings. Indeed, government bonds could have a place in the MPFs and pension plans for employees, as well as being the nest eggs for retirees who are living longer and spending more years living on their retirement savings.

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