香港董事學會
The Hong Kong Institute of Directors
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The Government's Proposed Legislative Amendments on Adoption of Fair Value Accounting for Financial Instruments for Tax Reporting

This is in response to the letter from the Financial Services and the Treasury Bureau dated 12 July 2018 relating to certain proposals to amend the Inland Revenue Ordinance (Caps.112) so as to allow the computation of assessable profits arising from financial instruments on a fair value basis for tax reporting.

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The present proposal has the aim of providing legal backing for the recognition of financial instruments on a fair value basis for tax reporting. The impetus for the law change was the Court of Final Appeal decision in Nice Cheer Investment Limited v CIR (2013), 16 HKCFAR 813, where unrealised profits were ruled to be not chargeable to profits tax under the existing provisions of the Inland Revenue Ordinance.

We trust the proposal if adopted will serve the purpose. The larger issue is whether taxpayers should ever be taxed on unrealised profits.

The Hong Kong Financial Reporting Standard 9 does require financial instruments to be accounted for on a fair value basis, but we do not believe fair value accounting is exactly meant for taxation purposes. When taxpayers are to pay tax because of an increase in accounting value but the "profits" of which remain unrealized, some may conceivably have difficulty in meeting the tax bill solely because of some paper gain in "fair value". And when the value of the subject asset is finally realized, such may actually be at a loss.

To assess tax on fair value gains but which remain unrealized profits can be an exercise subject to gaming and manipulation. Adopting different bases of valuation can result in much variation over the level of "profits" for which tax is to be assessed.

The 12 July 2018 letter from the FSTB mentioned that some taxpayers who will be most affected – financial institutions and securities dealers, for instance – are receptive and may indeed be yearning for computing assessable profits on a fair value basis. We note that the proposed amendments are to permit taxpayers to make such an (irrevocable) election; fair value accounting of financial instruments for tax reporting is not to be mandatory. We nonetheless think the larger community should first consider the merits and drawbacks of assessing tax on unrealized profits.

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