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19 February 2010

The Hon John Tsang JP  
Financial Secretary  
The Government of the HKSAR  
5/F, Central Government Offices, Main Wing  
Lower Albert Road  
Central, Hong Kong

Dear 

**HKIoD's Submission on 2010-11 Government Budget**

The Hong Kong Institute of Directors ("HKIoD") is pleased to forward our views on the 2010-11 Government Budget.

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

In relation to the 2010-2011 Budget, we have gone through the processes of consulting our members and conducting focused review by our Economic and Public Affairs Committee under the chairmanship of Mr Christopher To. Hence, the submission represents our consolidated collective views.

Should you require further information regarding our submission, please do not hesitate to contact me on tel no. 2889 9986.

Thank you very much for your kind attention.

With best regards

Yours sincerely  
THE HONG KONG INSTITUTE OF DIRECTORS



Dr Carlye Tsui  
Chief Executive Officer

Enc

cc Dr Kelvin Wong, Chairman, HKIoD  
Mr Christopher To, Council Member and Chairman, EPA Committee

### HKIoD's recommendations for Government Budget 2010-11

The Hong Kong Institute of Directors ("HKIoD") is pleased to submit its views on the Government Budget for the 2010-11 year.

#### **On fiscal policy and economic development**

The HKIoD reiterates its view that the Government should rethink the way it manages the fiscal budget over business cycles. While we recognise the need for fiscal prudence, the Government must also continually invest in Hong Kong's future development. We think the Government should eye more towards a balanced budget over business cycles rather than a tax and expenditure approach aiming for balance in too short a term.

Insofar as Hong Kong's economic developmental path will tie closely to the development of the Mainland economy, it is inevitable that Hong Kong must participate closely to the national developmental plan. The Financial Secretary recognised this point in his last Budget. As Hong Kong positions itself in the national planning, the Government must also lead and champion Hong Kong's own thinking of its strategic direction, and be prepared to adopt appropriate budget measures to move towards that direction.

A number of infrastructure projects are now under way or will commence soon. These are important public projects for Hong Kong, keeping it modern and competitive. As the Government undertakes these current projects and plans new ones, we encourage the Government to articulate clearly the purpose of these developments and create opportunities for the private sector to participate.

We look forward to further initiatives and measures to better enable Hong Kong to become the choice offshore Renminbi business centre.

#### **Support the manufacturing SMEs**

The HKIoD emphasises the need for the Budget to have measures to support Hong Kong's manufacturing sector. As we noted before, if our manufacturing sector were to wane, it will also have an adverse impact on our export-import sector and our logistics industry.

#### *Tax treatment of "import processing" arrangements*

We reiterate our urge to 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

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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.

#### *Support from the SAR government's economic & trade offices*

We propose a re-examination of the role and function of the SAR government's economic & trade offices (or the ETOs) on the Mainland, and allocation of additional resources to enable them to better support Hong Kong businesses operating in their responsible regions. We believe the ETOs on the Mainland can serve a stronger function; for example, in helping Hong Kong businesses gain access to the domestic market or to obtain needed credits and financing to support their operations. The ETOs can also be anchor points for mutual support among Hong Kong businesses operating in various parts on the Mainland, and coordinators of efforts or resources from various business chambers, trade associations and non-governmental organizations to support Hong Kong businesses in their respective regions.

#### **Nurturing and keeping the talents for economic growth**

In his last Budget, the Financial Secretary emphasised the importance of human capital as the most valuable resource for sustaining our economic edge. We agree.

#### *Corporate governance training*

One area of human capital development that needs to be promoted is corporate governance. The HKIoD has long supported the promotion of corporate governance training. Directors

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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 the SME Loan Guarantee Scheme and the Special Loan Guarantee Scheme. 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 propose that the SME Training Fund be re-activated, or that, in conjunction with the SME loan/guarantee schemes currently in operation, 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 on all expenses (whether revenue or capital in nature) for recognised training activities in corporate governance subject matters.

*Our talents are among our younger generation*

The HKIoD believes it is important to support the nurturing and development of our young workers. They are the human capital important to Hong Kong's future. We propose measures to assist our young workers in the following ways:-

- Assistance in continuing education: 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 young workers pursuing continuing education make interest payments on study loans that they obtain from financial institutions. To further help these young workers, we propose that they be allowed a further tax deduction on the amounts paid as interest on the study loans. The Government can consider imposing an age limit for persons to be eligible for the interest payment subsidy and the tax deduction. 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 young workers' loan applications.

In this connection, 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. 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.

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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 believe it will help train more young workers for the Six Industries if the subjects of reimbursable courses can be expanded into appropriate study areas. 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: We propose a tax deduction for individual taxpayers on expenses associated with the taking of examinations towards the attainment of recognised professional qualifications. This will help produce workers with requisite professional knowledge and qualifications to serve the needs of Hong Kong as an international financial centre. To prevent abuse, the Government can consider introducing appropriate caps for such deductions.
- Language training: We propose a tax deduction for individual tax payers on expenses associated with the taking of examinations towards the attainment of recognised language proficiency certification. This will help produce workers with requisite language skills to serve the needs of Hong Kong as an international financial centre. To prevent abuse, the government can consider introducing appropriate caps for such deductions.
- Internship opportunities: We propose further incentives, through direct funding, tax deductions or otherwise, to Hong Kong taxpayers who employ Hong Kong youth as interns in their local or Mainland operations. To prevent abuse, the Government can consider introducing appropriate measures to stipulate the conditions to qualify for the incentives. We note that last year's Budget introduced the "Internship Programme for University Graduates" initiative. Our proposal has the effect of extending and enhancing the initiative. While the industrial and business sectors may be the more likely to benefit, we think the initiative can have another application. We note that last year's Budget introduced the "Operation Building Bright" campaign for maintenance of dilapidated buildings. In light of the recent building collapse tragedy, we think that if building contractors and businesses in related fields are given incentives to employ Hong Kong youth as interns, it can conceivably bring about a bigger work force at an affordable cost to take on building repair works and related business activities, and thereby addressing a social issue urgently requiring attention.

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### *Work-life balance*

We urge the government to consider introducing measures that will encourage enterprises and employers to promote work-life balance, so to ensure our talents will stay. Related measures may also include incentives to employers to upgrade work equipment and environment to promote occupational health.

### *Air quality*

Poor air quality has been cited as a major factor in people's decision of whether to stay and work in Hong Kong. In light of the Air Quality Objectives Review, we urge the government to formulate long-term air quality management strategies and allocate necessary resources for their implementation.

### *Public health*

The working population will have keen interest in the healthcare financing options for Hong Kong going forward. This affects the cost and quality of public healthcare available to them and the financial burden they may have to bear to support public healthcare to society at large. We ask the Government to present its proposals on healthcare financing and consult the public on this matter soon. Reaching a public policy decision on healthcare financing is an important step towards the longer-term development of a viable healthcare policy to tackle Hong Kong's public health issues, including those arising from or relating to an ageing population, the prevention and control of infectious diseases, and the gap of unmet medical needs.

We ask the Government to adopt measures, budgetary or otherwise, to enhance service quality and prevent medical incidents. To achieve the Government's previously expressed desire to develop Hong Kong as a regional healthcare centre, Hong Kong must be able to maintain a high standard of general and specialist healthcare services.

We also ask the Government to direct additional resources to support research and development in medical and public health issues, biomedicine and Chinese medicine.

### **A caring community**

#### *Building maintenance and urban renewal*

In the face of the recent building collapse tragedy, we urge the Government to introduce further measures to enhance the safety of old buildings and to accelerate urban renewal. We note that the Government has proposed legislation to require mandatory building and window inspections. It will, however, take some time before the proposed legislation becomes law. We need some measures in the interim to assure the public.

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*Help people construct their future*

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

*Support the elderly*

The HKIoD appreciates the Government's efforts and initiatives to support the elderly, as announced in last year's Budget and the 2009-10 Policy Address. We look forward to further measures in this regard.

*The elderly can be a treasure for social enterprises*

The HKIoD also believes the elderly population is a resource our society should continue to tap into, generally and in the area of social enterprises particularly. The Chief Executive announced that it is government policy to enhance cross-sector collaboration in the development of social enterprises. We have in Hong Kong a good body of retired persons who have diverse background and experience in business or in the professional trade who can be great mentors for social entrepreneurs. Many can even play active roles managing and directing social enterprises. We hope to see further initiatives and measures to encourage able and willing retired persons take part in social enterprise development.

**Taxation and related matters**

*Corporate profits tax rates*

We do not recommend adjustments to corporate profits tax rate for 2010-11.

*Tax base, land-related revenue and land policy*

The Financial Secretary noted that many small businesses pay little or no taxes. If small (and small and medium-sized) businesses can enhance their business revenue and profitability, they could become a significant contributor of profits tax revenue. Small businesses and SMEs are also the major providers of jobs to our economy. By supporting their development, we can potentially put more people on the payroll and enhance our salaries tax revenue.

We are mindful that increases in salaries and profits tax cannot be a complete solution to the problem of a narrow tax base. We agree this is not an appropriate economic time to introduce drastic changes to the tax base, whether in the form of GST or otherwise. But we ask the Government to continue its effort to look for ways to broaden the tax base and consult the public at appropriate times.

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Land and property-related revenue has traditionally taken a significant place in the Government's finances. We note that a solution to broaden Hong Kong's tax base must necessarily tie to the future direction of land (and housing) policy.

The Chief Executive in his Policy Address acknowledged that land resources are crucial to the development of the Six Industries. We reiterate our views that land supply should not just be a matter of revenue generation. The decisions to put Hong Kong's land resources to various use must not only comport with strategic developmental goals but also with sustainable development of the territory on a general scale.

#### *Competitiveness of our tax system*

We note that the availability of tax incentives and concessions, which has the effect of lowering the effective tax rates for businesses, 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 urge the Government to review the tax regime and to add or augment tax incentives to better match business needs.

#### *Certain tax incentives to support development*

We propose incentives to support the development in several areas:

- For a knowledge-based economy: We believe that at 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. We note that the Chief Executive announced the "R&D Cash Rebate Scheme" in the 2009-10 Policy Address. The HKIoD welcome and support the initiative. We suggest an increase of the current rebate rate of 10% to a higher level. We further propose a profits tax deduction of up to 200% of R&D costs incurred by Hong Kong taxpayers. We support the calls to extend the current practice of allowing deduction of expenditure incurred in the purchase of patent rights and know-how in calculating assessable profits to enable deduction of costs for the purchase of trademarks, copyrights, licensing rights and other intangible assets. 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 IPR are resulting from the taxpayer's R&D activities. We believe these are suitable measures to help build our knowledge-based economy and make Hong Kong an intellectual property hub.



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- For a better environment: We reiterate our call for the Government to 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 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. 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. We also propose concessionary tax rates for income earned by regional headquarters for management and consultancy services provided to associated entities overseas. We also propose that interest income received by regional headquarters from loans made to their overseas associates be exempted from taxation.

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