



Revenue Mobilization Measures and Current Tax Issues in Hong Kong



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Outline

- Introduction
- Establishing the Context
- Revenue Mobilization Measures
- Current Tax Issues
- Challenges
- Closing Remarks



Introduction

- Important to increase domestic revenue to fund public spending
- Distribution effect – link between taxation and public spending – even more significant
- Increasing revenues and allocating them to priority sectors with effective outcomes remain a challenge



Establishing the Context

● Fiscal Policy ⁽¹⁾

- ◆ 2011 Index of Economic Freedom by The Heritage Foundation –

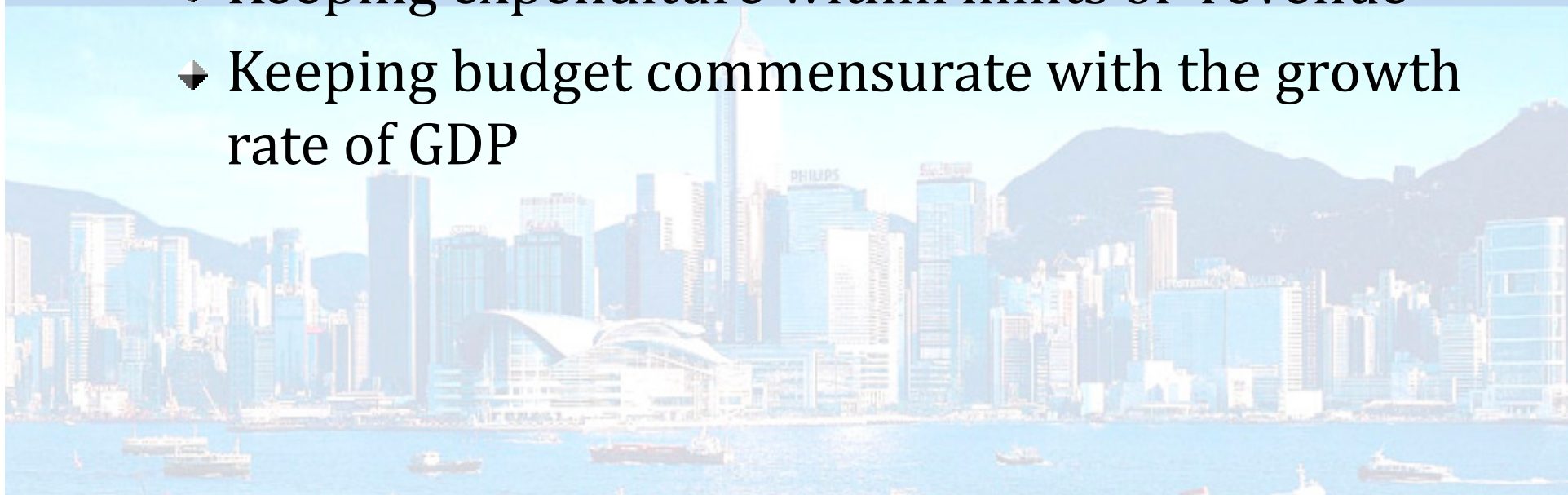
Hong Kong : the world's freest economy with minimal corruption



Establishing the Context

● Fiscal Policy ⁽²⁾

- ◆ An efficient, fair and clean government
- ◆ Keeping expenditure within limits of revenue
- ◆ Keeping budget commensurate with the growth rate of GDP





Establishing the Context

● Fiscal Policy ⁽³⁾

- ◆ For 2010-11¹, a surplus of HK\$75.1 billion (US\$9.6 billion)²
- ◆ Fiscal reserves stood at HK\$595.4 billion (US\$76.3 billion)
= 23 months of Government expenditure, or 34% of GDP

Note:

1. The fiscal year was from 1 April to 31 March
2. US\$1 = HK\$7.8



Establishing the Context

● Fiscal Policy ⁽⁴⁾

- ◆ For 2011-12, total Government spending estimated to reach HK\$371.1 billion (US\$47.6 billion)
- ◆ Increase spending on education, health and social welfare
- ◆ Strong correlation between revenue collection and poverty reduction as well as public development



Establishing the Context

● Fiscal Policy ⁽⁵⁾

- ◆ Adequate fiscal reserves as a buffer to maintain Government expenditure at steady level in economic downturns
- ◆ Protection of the poorest through basic public spending is an overarching concern



Establishing the Context

● Tax System ⁽¹⁾

- ◆ Territorial tax system
- ◆ Tax laws are simple and clear
- ◆ Tax rates are low
- ◆ Tax types are few
- ◆ No tax on capital gains
- ◆ No withholding tax on dividends and interest
- ◆ No VAT



Establishing the Context

● Tax System ⁽²⁾

- Only business profits, salaries and wages, and property rental income derived in Hong Kong are subject to tax
- Low flat corporate tax rate at 16.5%
- Progressive rates for salaries tax starting at 2% and capped at 17% on net chargeable income, or
- Standard rate at 15% of net total income (no deductions or allowances), whichever is less



Establishing the Context

● Tax System ⁽³⁾

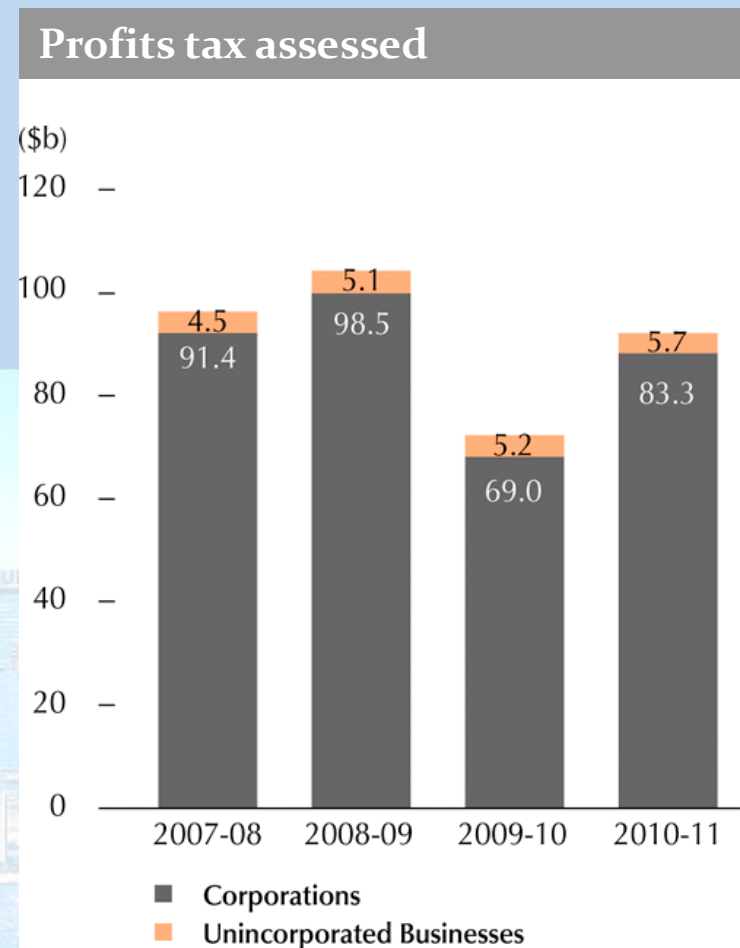
- ◆ Tax revenue is mainly contributed by large companies and high income earners
- ◆ In 2008-09, only some 80,000 corporations (or 13%) out of about 630,000 registered corporations paid profits tax
- ◆ Profits tax paid by the top 1,100 corporations contributed 67% of the corporate profits tax revenue



Establishing the Context

● Tax System (4)

- ◆ Profits tax assessed for past 4 years predominantly contributed by corporations rather than smaller-sized unincorporated businesses



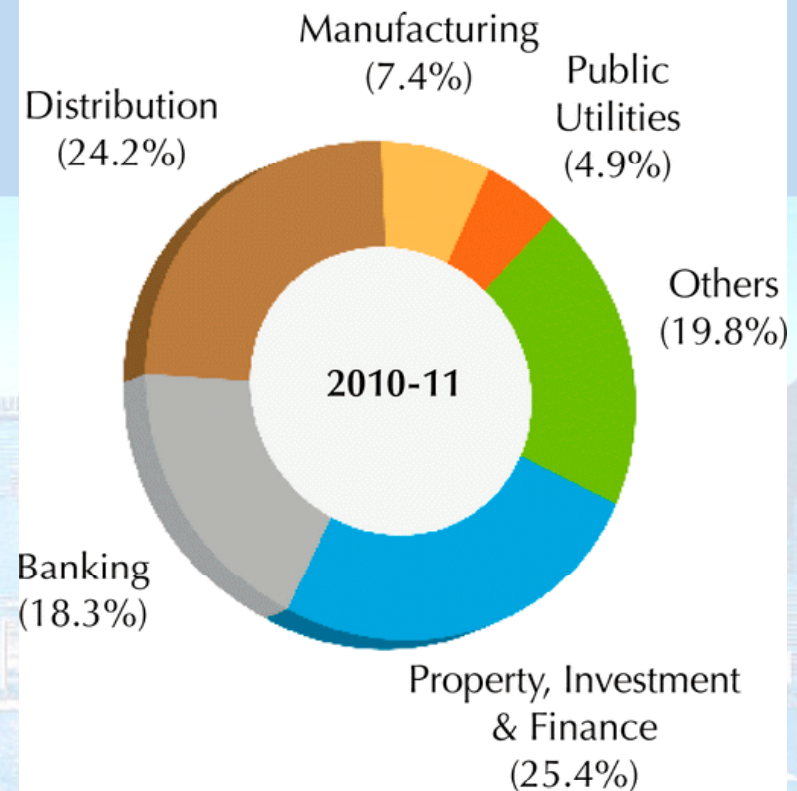


Establishing the Context

● Tax System ⁽⁵⁾

- ◆ In 2010-11, property and financial sectors contributed 43.7% of the profits tax assessed

Corporation profits tax assessed ratios by business sectors





Establishing the Context

● Tax System ⁽⁶⁾

- ◆ Generous personal allowances (HK\$108,000 or US\$13,800 basic allowance, and HK\$216,000 or US\$27,700 married person's allowance)
- ◆ Ordinary working people pay hardly any tax

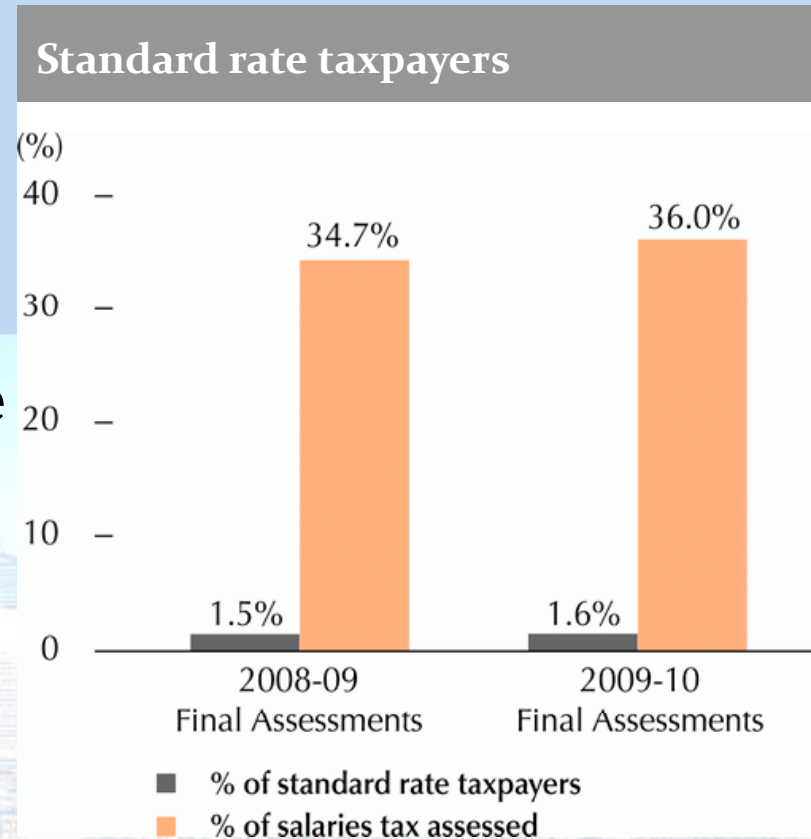




Establishing the Context

● Tax System ⁽⁷⁾

- ◆ Number of standard rate taxpayers (high income earners) is on the rise and contributed 36% of the salaries tax assessed for the final assessments of the year 2009-10

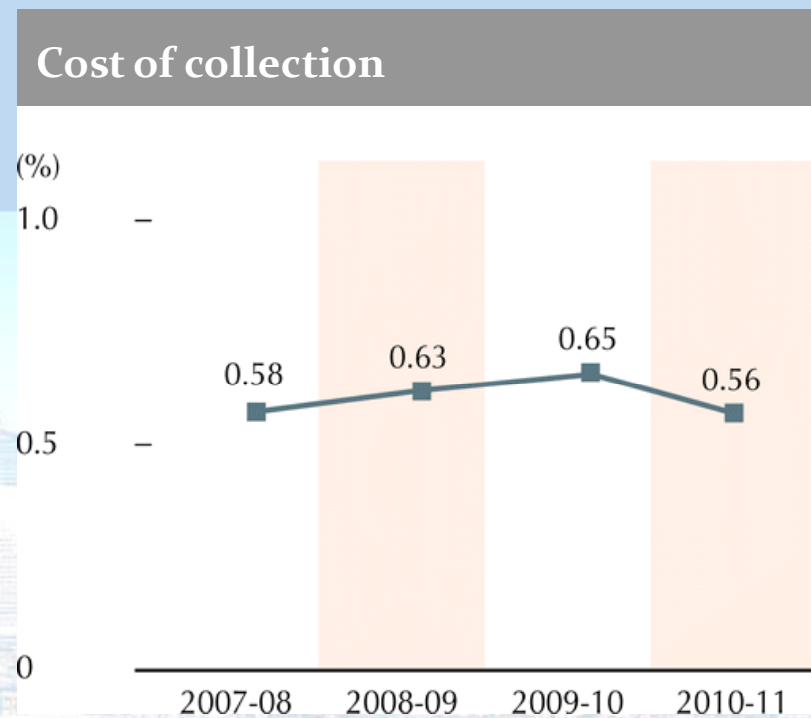




Establishing the Context

● Tax System ⁽⁸⁾

- No Pay-As-You-Earn
- No serious revenue collection problem
- Cost of revenue collection dropped with a rise in revenue collections
- A fair and effective tax system strengthens revenue mobilization and helps alleviate poverty and inequality





Revenue Mobilization Measures

● Tax Administration ⁽¹⁾

- ◆ Inland Revenue Department (IRD) is an executive arm under the Financial Services and the Treasury Bureau (equivalent to the Ministry of Finance)
- ◆ Responsible for administering the tax laws and providing technical support to the policy bureau



Revenue Mobilization Measures

● Tax Administration ⁽²⁾

- Tax revenue assessment and collection remain independent from political cycle
- IRD collects profits tax, salaries tax, property tax, stamp duty, betting duty and business registration fees
- Other revenues, such as rates, government rent, tax on first registration of motor vehicles, yields from land transactions, etc. are collected by other Government departments



Revenue Mobilization

Measures

● Tax Administration (3)

- ◆ In 2010-11, IRD collected HK\$209 billion (US\$26.8 b.) revenue

Revenue collected by tax type

Type of tax	2007-08 (\$m)	2008-09 (\$m)	2009-10 (\$m)	2010-11 (\$m)
Profits tax -				
Corporations	86,775.6	99,294.4	72,224.3	88,191.4
Unincorporated businesses	4,647.1	4,857.1	4,381.1	4,991.7
Salaries tax	37,479.5	39,007.9	41,245.4	44,254.7
Property tax	1,240.6	832.5	1,677.6	1,647.1
Personal assessment	3,586.6	2,151.1	3,655.8	3,921.8
Total earnings & profits tax	133,729.4	146,143.0	123,184.2	143,006.7
Estate duty	353.4	176.0	185.1	212.8
Stamp duty	51,549.1	32,162.1	42,382.6	51,005.1
Betting duty	13,048.4	12,620.3	12,767.1	14,759.1
Business registration fees	1,565.8	154.4	578.7	35.7
Hotel accommodation tax (Tax rate reduced to 0% from 1 July 2008)	450.4	222.9	0.0	0.0
Total revenue collected	200,696.5	191,478.7	179,097.7	209,019.4
% change over previous year	29.4%	-4.6%	-6.5%	16.7%

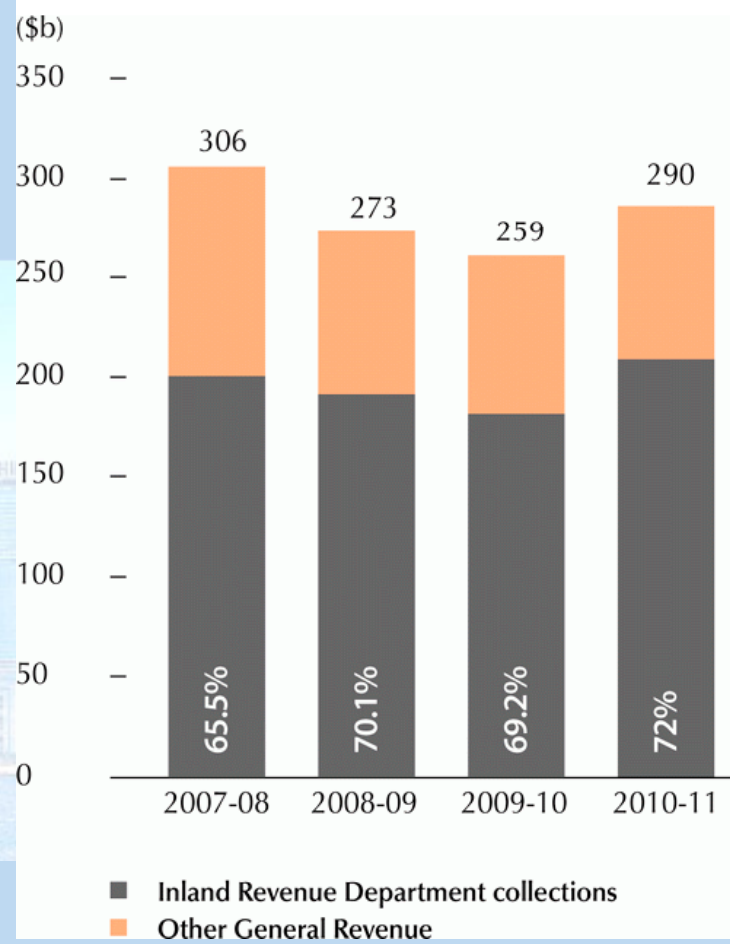


Revenue Mobilization Measures

● Tax Administration (4)

- ◆ Accounted for 72% of the Government General Revenue

Government General Revenue



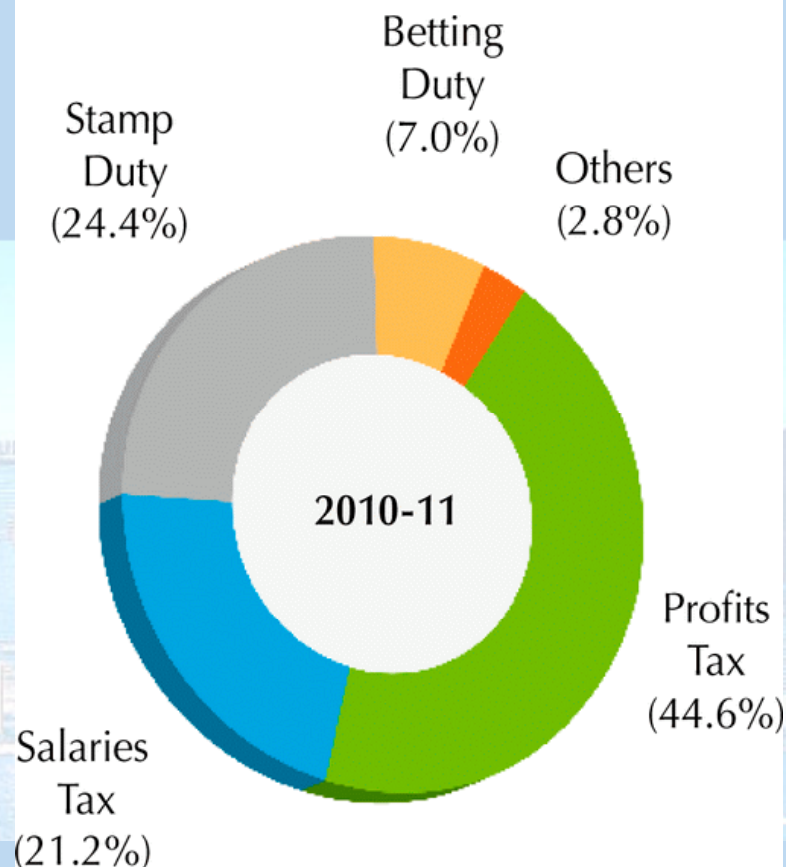


Revenue Mobilization Measures

● Tax Administration ⁽⁵⁾

- ◆ Profits tax and stamp duty together made up 69% of the total revenue collected

Composition of the revenue collection





Revenue Mobilization Measures

● Tax Administration ⁽⁶⁾

- ◆ An efficient, fair and transparent tax administration is capable of promoting voluntary compliance, protecting and strengthening the revenue base
- ◆ IRD is committed to becoming a trusted authority, an enabler, a fair administrator and a firm enforcer of the tax laws



Revenue Mobilization Measures

- The Service / Enforcement Continuum ⁽¹⁾
 - ◆ A suite of proactive and reactive strategies (service, legislation, enforcement)
 - ◆ “EEC” service strategy
 - ◆ Easy to understand
 - ◆ Easy to complete
 - ◆ Communicating with taxpayers



Revenue Mobilization Measures

- The Service / Enforcement Continuum ⁽²⁾
 - Customer-oriented electronic services
 - Streamlined compliance processes
 - Pre-populated returns
 - Expanded telephone help-lines
 - Advance rulings
 - Departmental Interpretation and Practice Notes (DIPNs)
 - Informative website
 - Easier to comply; harder to evade or avoid tax



Revenue Mobilization Measures

- The Service / Enforcement Continuum ⁽³⁾
 - ◆ Enforce compliance through legislation, audit and investigation, litigation and criminal investigation
 - Special teams to deal with tax avoidance cases
 - Designated sections to scrutinize returns of financial institutions, insurance companies, listed companies, etc.
 - Establish firm control of the largest taxpayers
 - Tough and credible enforcement to deter non-compliance and build community confidence



Revenue Mobilization Measures

● Building up Capabilities

- ◆ Investment in technologies to build up capabilities in risk identification, risk assessment and risk prioritization
- ◆ Investment in training to strengthen professional competency of staff to deal with global and complex issues



Current Tax Issues

● Tax Avoidance Schemes ⁽¹⁾

- ◆ Territorially-based tax system
- ◆ Siphon off locally derived income to offshore jurisdictions
- ◆ Create onshore tax deduction and offshore non-taxable income
- ◆ Dual contracts for individuals to segregate part of local income to offshore source



Current Tax Issues

● Tax Avoidance Schemes ⁽²⁾

- ◆ Focus audit on high-risk and high-yield cases
- ◆ In 2010-11, the Anti-tax avoidance Sections completed 234 tax avoidance cases and assessed tax and penalties of HK\$2.19 billion (US\$280 million)
- ◆ Audit strategies are effective in combating tax avoidance and protecting our tax base.

Results of the audit on tax avoidance cases

	2007-08	2008-09	2009-10	2010-11
Number of cases completed	188	218	206	234
Understated earnings and profits (\$m)	4,246.7	1,978.4	6,742.0	11,676.1
Average understatement per case (\$m)	22.6	9.1	32.7	49.9
Back tax and penalties assessed (\$m)	591.0	527.1	1,240.5	2,193.2



Current Tax Issues

- Expanding Tax Treaty Network
 - ◆ In March 2010, tax laws were amended enabling Hong Kong to adopt the OECD 2004 version of the Article on Exchange of Information (EoI Article)
 - ◆ To date, a total of 22 comprehensive double taxation agreements were signed (14 OECD countries, 19 Global Forum members)
 - ◆ 19 of these with OECD 2004 EoI article



Current Tax Issues

● International Non-compliance

- ◆ Important to establish a global approach to deter, detect and counter abusive tax schemes
- ◆ Make best use of information exchange articles in CDTAs
- ◆ Enhance international cooperation and mitigate compliance risks in cross-border transactions



Current Tax Issues

● Transfer Pricing

- ◆ More companies with global footprint established businesses in Hong Kong
- ◆ No explicit transfer pricing rules
- ◆ Tax laws and case laws applied to deal with transfer pricing issues
- ◆ Two DIPNs issued on transfer pricing
- ◆ Prepared to introduce an Advance Pricing Arrangement regime in Hong Kong shortly



Current Tax Issues

● Preferential Tax Treatments

- ◆ Hong Kong offers no tax concessions to particular entities, industries or sectors
- ◆ Concessions and preferential tax treatments seriously impede revenue mobilization
- ◆ Where profits are not derived from, or not taxed in, Hong Kong, we do not grant depreciation allowances to the Hong Kong enterprises concerned



Challenges

● Narrow Tax Base ⁽¹⁾

- ◆ Profits tax is the largest source of revenue
- ◆ Highly sensitive to economic fluctuations
- ◆ Hong Kong's population is ageing
- ◆ IMF estimates, by 2030, health-care costs could rise by 7 percentage points of GDP
- ◆ Higher public spending but narrower revenue base



Challenges

● Narrow Tax Base ⁽²⁾

- ◆ A low-rate goods and service tax introduced for consultation in 2006
- ◆ Withdrawn in December 2006 for lacking public support
- ◆ How to broaden Hong Kong's tax base remains a challenge



Closing Remarks

- No single approach in revenue mobilization
- Build relationship with other tax administrations and international organizations
- Develop best practices
- Customize to suit local conditions



Thank You

