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11 February 2020

Dear Sir/ Madam,

2020-21 Budget Proposals

Coronavirus outbreak deals another blow to the Hong Kong economy, which is already on the downward trend as a result of the prolonged social unrest, China-US trade war and global economic slowdown. It is therefore of utmost importance for the Hong Kong SAR Government to provide simple, immediate and direct relief to the community amid all the adversities. Hong Kong should also continue to improve our competitiveness to attract investments and promote growth as well as to proactively consider viable options to broaden our narrow tax base. Our proposals to maintain a strong community and to enhance Hong Kong's tax competitiveness are as follows:

A. Super tax reduction

As many businesses, individual taxpayers and their families are severely affected by the economic downturn in Hong Kong last year and the recent coronavirus epidemic, we propose to introduce a one-off super tax reduction for Profits Tax, Salaries Tax and Tax under Personal Assessment for the year of assessment 2019-20 by 100%, subject to a ceiling of HK$60,000, to provide immediate relief to Hong Kong taxpayers.

B. Livelihood

While a lot of the Government's resources are spent on those in need, most of Hong Kong's middle-class families are not eligible to enjoy those benefits. Many of them are burdened under skyrocketing rental expenses, expensive private health care and children education expenses etc. We reiterate a number of much needed proposed deductions that would hopefully provide relief for the middle-class taxpayers:

1. Increase basic/married person's allowances and reduce progressive rates for Salaries Tax and Personal Assessment

Currently, the basic allowance and married person's allowance granted to individual taxpayers is HK$132,000 and HK$264,000 respectively. There has been no adjustment to these allowances since the year 2016-17. We propose to increase the basic allowance and married person's allowance to HK$153,000 and HK$306,000 respectively and also to widen the first three bands from HK$50,000 each to HK$55,000 to alleviate the economic burden of taxpayers.

We also recommend 0% rate for the first band to save the Inland Revenue Department (IRD)'s administrative costs in issuing Salaries Tax assessments to taxpayers whose tax payable would be about HK$1,200 or less, as around 613,000 (ie about 1/3) taxpayers fell into this category for the year of assessment 2017-18.

2. Deduct rent paid on private housing

Taxpayers are entitled to claim deduction of home loan interest incurred on loans taken to finance the purchase of dwellings used as place of residence. The maximum deduction is HK$100,000 per annum for 20 years. Taxpayers who lease private housing as their place of residence, however, cannot enjoy such preferential deductions. As the price of properties stands high, we estimate more and more people including the middle-class may rent instead of buy. We propose to allow, on a similar basis, deduction of rent paid by qualified taxpayers on private housing occupied as place of residence. Taxpayers can opt to claim deduction on either home loan interest or rent paid on private housing during the 20-year period. The maximum amount of deduction for rental payment for each year remains at HK$100,000. This measure would reduce rent-paying taxpayers' tax burden and also be seen as fair policy.

3. Deduct expenses to maintain parents

Under the current tax legislation, only taxpayers who reside with parents continuously throughout the whole year are entitled to additional dependent parent allowance. Taxpayers who pay fees to residential care homes for parents may claim a maximum deduction of HK$100,000 for elderly residential care expenses although they do not reside with their parents. However, taxpayers who do not reside with their parents but pay for their parents' living and domestic helpers are not entitled to any additional allowance. We propose a deduction of expenses (eg rent/mortgage payments and expenses to hire domestic helpers etc) incurred by taxpayers to take care of parents who do not reside with the taxpayers. Same as deduction for elderly residential care expenses, the maximum deductible expenses is capped at HK$100,000. This measure helps relieve financial burden on taxpayers who maintain their parents. It also provides a degree of incentive to encourage people to support their aging/aged parents.

4. Deduct costs of children education

It has aroused public concern about Hong Kong's aging population and low birth rates in the recent decade. Some researchers suggest that the young couples are reluctant to have children due to high cost of raising a child in Hong Kong. Given the ever increasing cost of raising a child, in particular education cost for those who are studying in private schools, we propose to introduce a deduction for child education expenses subject to a ceiling by reference to the subsidy currently provided by the Government to the aided schools and public schools.

5. Deduct costs of employing domestic helpers

Many middle-class families need to have both spouses/parents take up full-time jobs leaving them with limited options but to hire domestic helpers to take care of the elderly and children at home. We suggest granting a deduction equal to the actual wage for employing one domestic helper, capped at amount equivalent to the minimum wage of HK$4,630 per month, for each household in order to relieve the financial pressure on the middle-class.

6. Deduct tuition fees for health and sports related courses

The Government spends a substantial portion of its budget on public healthcare system every year. With our aging population, the demand for public healthcare may only increase unless the public become more vigilant for their health and wellbeing. To encourage more people to learn about health-related knowledge and practical tips for their wellbeing, we suggest granting a deduction up to HK$10,000 per annum for tuition fees spent by taxpayers in attending health and sports related courses. With the Government's commitment in putting more resources in promoting and encouraging health education, Hong Kong will become a healthier city and hopefully this could reduce our public healthcare expenditure in the long run.

C. Enterprises

The Organisation for Economic Co-operation and Development (OECD)'s project on addressing the tax challenges of the digital economy - commonly referred to as "Base Erosion and Profit Shifting 2.0" or "BEPS 2.0" - could potentially change fundamental elements of the global framework for taxing international businesses. Impact on Hong Kong's tax revenue could be huge and far-reaching. While awaiting OECD's final report that would be delivered by the end of 2020, Hong Kong should endeavour to ensure our tax system remains competitive.

1. Reduce profits tax rate

The two-tiered profits tax rates regime is primarily for the benefit of small and medium enterprises, and it is restricted to only one entity within a group of connected entities. To attract larger corporations/groups of entities amid the global trend of tax rates cut, we propose to reduce the profits tax rate for corporations to foster a more favourable business environment as a whole and enhance Hong Kong's competitiveness in the region.

2. Enhance tax certainty

The statutory time limit for the IRD to raise an assessment or additional assessment is generally 6 years but there is no time limit for the IRD to adjust a taxpayer's tax loss position. Therefore, taxpayers have to live with the uncertainty of whether their tax position should be considered final, particularly enterprises that sustain tax losses. Tax certainty is crucial to stimulate economic growth and promote investment. Uncertainty in the tax position will no doubt give rise to additional tax administrative burden on taxpayers and affect their desire to invest in Hong Kong. There are also practical considerations such as a relatively more fluid workforce and high cost in maintaining historical records in a costly operating environment. In Singapore, the statutory time-bar period is four years. To streamline tax administration and enhance Hong Kong's tax certainty, we propose to shorten the statutory time-bar period to four years and finalising the tax loss status also within four years.

3. Introduce group tax relief/allow tax losses to be carried backward

Tax losses can only be carried forward to set off against a taxpayer's future assessable profits. In light of the current economic and social conditions, it is possible that many taxpayers will sustain tax losses for 2019-20 and they may not be able to fully utilise the losses in the coming year(s) if the adverse situations persist. We propose to introduce group tax relief or to allow tax losses to be carried backward to lower taxpayers' tax burden. This could also enhance the competiveness of Hong Kong's tax system as some neighbour countries, such as Japan and Singapore, provide similar tax relief.

4. Relax the conditions on Research and Development (R&D) expenditure deduction

We welcome the IRD's willingness to adopt a more flexible approach in its application of the deduction on the R&D expenditure, subject to certain limits, as explained in the Departmental Interpretation & Practice Notes No. 55. To further enhance the effectiveness of this tax incentive to attract enterprises to invest in R&D activities, we recommend the Government to consider further relaxation on deduction claims on costs recharged by/subcontracting fees paid to related companies.

Nowadays, it is not uncommon for multinational corporations (MNCs) to centralise R&D functions in one constituent entity partly for confidentiality reasons and partly because local approved institutes may not have the industry expertise and knowledge to suit the requirements of the taxpayers. While the group operating entity in Hong Kong would potentially derive taxable income from the benefits of the R&D work, it is not entitled to claim any R&D costs recharged or fees paid as deductible expenses unless it actively participates in the R&D project or only subcontracts an insignificant part of the R&D project. We recommend the criteria for qualifying R&D expenditure be relaxed to include all outsourced R&D activities or costs recharged under a cost sharing arrangement. Further, we strongly encourage the Government to accept designation of MNC groups' R&D entities in Hong Kong as designated local research institutes for tax purposes.

5. Promote green industries

People have become more aware of the importance to protect our environment. We propose the Government should formulate a comprehensive policy and provide subsidies/allowances to green industries, e.g. recycle industry. Currently, section 15(1)(c) of the Inland Revenue Ordinance deems any sums received by or accrued to a person by way of grant, subsidy or similar financial assistance in connection with the carrying on of a business in Hong Kong as taxable receipts. We propose to amend section 15(1)(c) to exclude Government's subsidy granted to green industries from taxable receipts in order to encourage more people to engage in such industries.

In addition, capital expenditure incurred on environmentally friendly machinery and equipment is currently deductible in the year of purchase and that on renewable energy and energy-efficient building installations is deductible over five years. To further encourage adoption of these expenditures to make Hong Kong more liveable, we propose that a super tax deduction (similar to that for R&D expenditures) be given.

D. Review Hong Kong's tax system and policy

We very much look forward to hearing from the Tax Policy Unit (TPU) their comments/recommendations on Hong Kong's tax system and policy. The global world of tax is evolving rapidly. The OECD's "BEPS 2.0" initiatives together with unilateral actions by other countries may have significant impact on Hong Kong's tax revenue.

We recommend the TPU to consider the following areas that may help to increase Hong Kong's tax revenue or to enhance our competitiveness in attracting investments:

1. Consider digital tax

A number of jurisdictions have introduced digital taxes in the form of indirect tax (eg France, Singapore) while the OECD is seeking comments on introduction of digital nexus for direct tax (ie corporation income tax) purposes. We recommend the TPU to explore the possibility of increasing tax revenue via digital tax.

2. Introduce luxury goods tax

A single-rate luxury goods tax is a viable option for Hong Kong to broaden the tax base without creating extra tax burden on the wider community.

3. Evaluate territorial basis of taxation

The OECD's proposed Pillar 2 under "BEPS 2.0" will effectively target profits that are not subject to tax at a minimum tax rate. This would have a significant implication on Hong Kong's offshore tax regime. We recommend that the Government should review our territorial source principle of taxation given the changing international taxation landscape.

We hope the above proposals are acceptable to you.

We would be pleased to discuss the above proposals further should you wish. Please contact the undersigned at 2218 3232 or agnescheung@bdo.com.hk, or Carol Lam, our Director, at 2218 8296 or carollam@bdo.com.hk.

Yours faithfully,
For and on behalf of
BDO Tax Limited

Agnes Cheung
Director, Head of Tax

AYC/CYL/BY/MK