2021-22 BUDGET PROPOSALS

February 2021

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8 February 2021

Dear Sir/Madam,

2021-22 Budget Proposals

Thank you for the opportunity for us to submit a proposal for the 2021-22 Financial Budget. We are pleased to provide in this document an overview of our tax proposition. We would be delighted to discuss this in more detail with you.

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BDO in Hong Kong, as part of the International BDO network, has committed to provide our clients with exceptional services since the establishment in 1981. BDO currently has over 60 directors and 1,100 staff in Hong Kong, and is the leading accounting firm in the small and medium-sized enterprises market.

We have set out on the following pages our suggestions for your kind consideration. We are very enthusiastic about this opportunity and we look forward to discussing it further.

If you have any queries regarding the contents of this document, please do not hesitate to contact Agnes Cheung, our Director and Head of Tax at 2218 3232 or agnescheung@bdo.com.hk, or Carol Lam, Director at 2218 8296 or carollam@bdo.com.hk.

Yours faithfully,

BDO Tax Ltd.

BDO Tax Limited

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INTRODUCTION

The outbreak of COVID-19 has brought upon unprecedented challenges and uncertainties, and its impact on Hong Kong and the global economy could be far-reaching. It is therefore of utmost importance for the Hong Kong SAR Government to provide simple, immediate and direct relief to support the community amid the pandemic. Facing the challenges and strong headwinds, Hong Kong should put more effort 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. COVID-19 specific measures

1. Super tax reduction

As many businesses, individual taxpayers and their families are severely affected by the economic downturn in Hong Kong and the 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 2020-21 by 100% subject to a ceiling of HK$60,000 to provide immediate relief to Hong Kong taxpayers.

2. Deduct COVID-19 testing costs

Employees working in industries that are subject to higher risk/exposure to COVID-19 in the course of their work are required to go for frequent COVID-19 tests, and the testing costs may not be reimbursed by the employers. Likewise, residents in districts with high infection cases will do the test wanting a peace of mind. To encourage more people to do the test based on their needs and at their convenience, we suggest allowing deduction on the actual COVID-19 testing costs incurred and exempt the reimbursements of testing costs by employers from salaries tax. Testing costs incurred by sole-proprietors and equity partners of partnerships should also be allowed as deductible expenses for profits tax purposes.

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, high living costs 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 widen tax bands for salaries tax and personal assessment

Currently, the basic allowance and married person's allowance granted to individual taxpayers are 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$160,000 and HK$320,000 respectively and also to widen the tax 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 who pay zero or very low tax. Based on the IRD's annual report, about 1 million of taxpayers (ie 56%) paid average tax of HK$376 or less for the year of assessment 2018-19.

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.

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 after public consultation, Hong Kong should endeavour to ensure our tax system remains competitive.

1. Reduce profits tax rate

While reducing profits tax rate for corporations to enhance Hong Kong's competitiveness in the region to attract investments should be considered amid the global trend of tax rates cut, we acknowledge that it might not be the right timing in light of the large fiscal deficit this year. As an immediate relief, we propose a one-off super tax reduction for profits tax for 2020-21 by 100% subject to a ceiling of HK$60,000 (see A1 above) while an overall reduction in tax rate is being considered.

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. Allow tax losses to be carried backward and introduce group tax relief

Tax losses can only be carried forward to set off against a taxpayer's future assessable profits. In light of the current economic conditions, undoubtedly many taxpayers, in particular those in the hardest hit industries such as tourism, hospitality and retail, will sustain tax losses for 2020-21. They may not be able to fully utilise the losses in the coming year(s) if the adverse situations persist or if it takes a longer than expected time for the economy to recover. We propose to allow tax losses to be carried backward such that taxpayers may "recover" some of their prior year taxes paid to finance their current businesses.

In addition, a number of neighbour countries, such as Japan and Singapore, provide group tax relief. We recommend the Government to consider introducing similar tax relief to enhance the competiveness of Hong Kong's tax system.

4. Introduce super tax deduction on IT equipment

Work from home has become the new normal for many businesses during the pandemic and will likely to be an ongoing trend. The trend for remote office and office automation has also continued. To encourage businesses to invest in the future to make work from home and office automation more effective and productive, we propose to allow a 200% deduction on IT equipment costs incurred and the related provision costs.

5. Relax the cap on deduction of charitable donations

Deduction of approved charitable donations is currently restricted to 35% of taxpayers' assessable profits. No deduction is allowed for companies in a tax loss position. To build a caring society and foster a culture of giving and sharing, we suggest to adjust the restriction upward to 50% of assessable profits and allow loss companies to claim deduction, restricted to 50% of the tax loss.

6. Allow tax credit/deduction of tax paid in non-treaty jurisdictions

Under the current practice of the IRD, no deduction is allowed on withholding tax paid in overseas jurisdictions that have no double tax treaties with Hong Kong on royalties, management fees and technical service fees even if such income is reported as chargeable income. The withholding tax paid is a genuine business expense incurred in the production of assessable profits, so we suggest to allow deduction either as a tax credit or as a deductible expense.

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

To attract enterprises to invest in R&D activities in Hong Kong, 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.

8. Promote green industries

The use of take-away boxes and personal protective equipment has skyrocketed during the pandemic, and the impact on the environment is substantial. It is therefore important that a comprehensive policy on green industries should be put in place and subsidies/allowances be provided to green industries, eg 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 look forward to hearing from the Advisory Panel on BEPS 2.0 and the Tax Policy Unit their comments/recommendations on strategies and measures to facilitate the continuous development of Hong Kong as an international financial, trading and business centre amid the rapidly evolving global world of tax. The OECD's BEPS 2.0 initiatives together with unilateral actions by other countries may have significant impact on Hong Kong's tax revenue which must be considered as well.

We recommend the Government to consider the following areas that may help increase Hong Kong's tax revenue or 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 and Malaysia). We recommend the Government to explore the possibility of increasing tax revenue via digital tax and to draw a clear roadmap on how to fit in the measures under BEPS 2.0 Pillar 1 locally.

2. Evaluate territorial basis of taxation

The OECD's proposed BEPS 2.0 Pillar 2 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.

3. Review tax system

Hong Kong will have a record high deficit in this financial year and forecast a deficit for the coming few years as well. To guarantee long-term and stable tax revenue, we recommend the Government to conduct a review of the current tax system and study the viable options for broadening the tax base.

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