



**The British
Chamber of Commerce
in Hong Kong**

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The Honourable Henry Tang Ying-yen GBS JP
The Financial Secretary
The Hong Kong Special Administrative Region of
The Peoples' Republic of China
Central Government Offices, West Wing
Lower Albert Road
Hong Kong

28 November 2006

Dear Financial Secretary

I am delighted to send the 2007 British Chamber of Commerce Budget Submission for your consideration. You will be aware that this is an exercise that we go through each year and have done so for many years with the aim of providing Government with a constructive yet well researched and prepared paper. This year is no exception and we hope that you will find it to be useful in the debate which you will now be going through.

While the paper looks at the economic and financial challenges which Hong Kong faces, it does so from a short, medium and long term perspective. There are two main issues that have emerged in the area of Government revenues. The first issue is that Government should resist the 'siren calls' for reductions in headline tax rates, changes to tax bands or personal allowance until the outcome of the consultation on the need to broaden Hong Kong's tax base is known. The second issue is that it is now time for Hong Kong to push ahead with the debate on and the review of the overall taxation regime and to determine whether or not reforms are required; central to success is that it is crucial for Government to move the process beyond a debate on the appropriate sources of revenue.

A priority objective of the Government and a key element of the long term strategy to maintain Hong Kong's position as the pre-eminent international financial centre is the further development of RMB business in all its facets. It is the RMB capability that gives Hong Kong a uniqueness that no other financial centre possesses. In addition it will have an important bearing on China's own economic development.

As you know, Financial Secretary, there are concerns which we believe deserve greater attention at all levels in Government - from the very top down. The first of these is the environment and its progressive degradation visible for all to see; we note that the Chief Executive has said that this is his "number one" priority. The second is the ageing of our population which will require both short and long term measures - the first of these being the urgent need for reform of the healthcare system and for a determination as to how it is to be financed. In terms of an ageing population, we also believe that there is a need to engage in a deeper and longer term study of the implications - there will surely be impacts here on retail and property markets, to name just a couple. Further we note that, hidden in the census figures, there are some disturbing ~~social issues~~ such as an accelerating divorce rate.

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Financial Secretary, we have commented previously to Government on the importance of longer term strategies. We are aware of the reasons for a shorter term agenda at present. However we believe that it is important that a balance is maintained between long term vision and plans with shorter term objectives. Policy initiatives often have to transcend more than are administration; this is especially true in the area of public finances and the advancement (or protection) of the financial services sector. Unfortunately deferring difficult decisions is not in the best interests of the community; we believe that well communicated strategies and policies will achieve public support. The British Chamber stands ready to work with Government at various levels to develop a vision strategies to tackle the many challenges which we as a community shall collectively face over the next quarter of a century. It is to be hoped that this paper will provide useful ideas for your team.

Yours sincerely

(Signed)

Christopher Page
Chairman

Enc

cc: Brigadier Christopher Hammerbeck CB, Executive Director

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BRITISH CHAMBER OF COMMERCE IN HONG KONG

2007-2008 BUDGET PROPOSALS

27th November 2006



EXECUTIVE SUMMARY

The British Chamber is one of Hong Kong's largest international business organisations, comprising major multinational companies and institutions, as well as a substantial number of SMEs. The Chamber represents a broad spectrum of British, Hong Kong, international and Chinese companies. Collectively, this membership makes a significant contribution to the Hong Kong economy and to employment, employing approximately 10% of Hong Kong's workforce. The Chamber therefore constitutes a representative cross-section of business opinion in Hong Kong and has a major interest in Hong Kong's continued success.

The Chamber prepares this paper on an annual basis for submission to and consideration by the Special Administrative Region Government ('SARG') as part of its annual budget preparation process. Throughout the paper we highlight the economic and fiscal concerns of our members and suggest ways in which these could be addressed in the forthcoming budget.

This year, our paper has been divided into four sections. The first section provides our current economic assessment for Hong Kong and forms a backdrop to the comments and recommendations contained in the second section, which covers short and medium term fiscal measures. The third section briefly comments on some of the medium to longer term challenges and pressures that Hong Kong faces from a fiscal perspective and examines Tax Reform measures more generally. The final section touches on measures to enhance Hong Kong's role as a Global Financial Centre and Environment related issues.

Since our previous submission, Hong Kong has continued to benefit from a robust economic situation with strong growth, continued consumer confidence, and a booming tourist sector. However, a number of threats to Hong Kong's fiscal well-being continue to exist including: the narrowness of its tax base; a return to an inflationary environment in Hong Kong, including high property prices; the risk of interest rate, oil and commodity price increases; and the continued threat of the impact of terrorism attacks and an avian flu outbreak on global trade. From an overall budgetary viewpoint, therefore, Hong Kong should remain cautious.

With this in mind, our main recommendations are as follows:

- The SARG should resist calls for reductions in the 2007/08 Budget in headline tax rates, any changes in tax bands or increases in personal allowances until the outcome of the



consultation on the need to broaden Hong Kong's tax base, including the possible introduction of a Goods and Service Tax (GST), is concluded.

- The Chamber still believes that SARG should review and reform the use of fiscal measures to discourage smoking. The current system of determining duties on alcohol should also be reformed
- As Hong Kong returns to being a high cost environment, with high property prices and salary levels, the SARG must do all it can to contain and reduce annual government expenditures in real terms.
- Now is the right time for the SARG to push forward with the debate and review of Hong Kong's overall taxation regime and whether reforms are required. The current consultation process of the broadening of Hong Kong's Tax Base is part of this process. But we believe that this process should extend beyond a debate on appropriate sources of revenues. It should also consider areas in which the administration and interpretation of Hong Kong's tax system can be improved and enhanced.
- As we have noted in past submissions, the SARG should continue to do all it can to cement Hong Kong's position as role as a Global Financial Centre, and as a hub for both inward and outward investment into and from the region, in particular, the Mainland.
- There are a number of issues which will impose pressures on Hong Kong's fiscal prosperity in the medium to longer term. These include the challenges associated with the demographic changes in Hong Kong's population over the coming years; the urgent need to reform Hong Kong's healthcare system; and the need to improve Hong Kong's worsening environment. These, and the many other issues the SARG faces, must be addressed urgently in a coordinated manner.

Section 1: General Economic Outlook and Medium Term Forecast

Hong Kong's economic performance in 2005 and 2006 continues to go from strength to strength, supported by strong momentum from both external and domestic factors. With robust growth from the Mainland China and the United States, activities in Hong Kong's external trade and related industries continue to be vibrant. Between Q4-03 and Q1-06, total exports have achieved ten consecutive quarters of double-digit growth. Meanwhile, exports of services have also been a critical driver to Hong Kong's economic performance, especially given the growing



trend of offshore trade. Tourism, an important export of Hong Kong, has retained a stable trend of expansion. Tourist arrivals in the first nine months of 2006 grew 9.5% year-on-year, with the Mainland China leading the way with 11% expansion and constituting over half of tourist arrival to Hong Kong.

Domestically, consumer confidence has been supported by rising employment, a falling jobless rate and a stable property market. Rapid economic expansion created 278,000 jobs between mid-2003 and Q3-2006, with much of the momentum in high value-added, service oriented pillar industries, such as professional services, tourism, financial services and logistics. Workers in some of these sectors have also experienced significant nominal growth in compensation. As a result, the unemployment rate continues to drift lower to below 5% - three and three-quarters percentage points lower than the peak observed in 2003.

Rising interest rates have indeed cooled the property market. Residential transactions fell by more than 30% year-on-year in H1-06. However, property prices have been riding on a steady trend and the number of negative equity cases has fallen to 8,777 cases in Q2-06, compared with the peak of around 106,000 cases at Q2-03. The stable wealth effect has anchored consumer sentiment.

On the back of such strong growth momentum, the economy is expected to expand by 7% in real terms in 2006, marginally slower than the 7.3 % in 2005 and 8.6% in 2004.

Further to strong economic expansion, Hong Kong's credit rating was raised one notch to AA by Standard and Poor's in July 2006, reflecting a number of positive factors. China's rating upgrade to A was a critical component, given the economic linkages between the two that binds their respective sovereign ratings together. The upgrade was also in recognition of the government's effort to restore fiscal surplus, Hong Kong's robust external position and its cyclical strengths. This has had the positive effect of reducing borrowing for corporate and financial institutions in Hong Kong, as well as reinforcing international investor confidence in Hong Kong's financial markets. Further upgrades will be dependent on economic and financial developments in China, as well as on how the SARG will enhance its fiscal policy, especially as the global economy is entering a more uncertain time.

While economic expansion observed between 2004 and 2006 has been exceptional, only marginal moderation in growth is expected in 2007. Real GDP growth for 2007 is forecast to reach at least 4.5%, above Hong Kong's recent medium-term expansion. The external



environment is likely to remain supportive to economic activities, with the US and China persisting with their steady growth path. Peaking of interest rates in the US, and hence Hong Kong, should also boost asset markets, including real estate in the SAR. The recent decline in energy prices, although prone to temporary surge, should also aid to contain inflationary pressure, as well as protecting profitability of industries and businesses that are sensitive toward such fluctuations. Such positive momentum is of course exposed to risk factors, such as diseases, geopolitical tension and terrorism, trade protectionism and rising investor risk aversion, but these have been anticipated by local businesses and experience from recent years suggest they are capable to handling such issues.

Section 2: Short and medium term fiscal measures

Revenue Measures

The Chamber continues to support the principle of a simple, low-rate, tax regime. However, the current model is possibly ill-suited to meeting Hong Kong's economic and demographic challenges over the next decade or two. While it is tempting to overlook the need for reform in Hong Kong's tax system while there is a period of strong economic performance, the Chamber strongly believes that this is exactly the time to consider and, if appropriate, implement the necessary reforms to preserve Hong Kong's long term fiscal well-being.

A medium to longer term goal for the SARG could be to place less reliance on sources of revenue which are susceptible to external factors, while at the same time widening the tax base. With the continued global trend for reductions in direct tax rates and many governments increasingly seeking to rely on indirect taxes and other sources of revenues, it is important that Hong Kong's tax system and headline tax rates remain competitive, especially when compared with those in other countries and locations in the Asia Pacific region, in particular Singapore, Malaysia and Mainland China.

However, in the short to medium term, the Chamber believes that the SARG should resist calls for reductions in headline tax rates, any changes in tax bands or increases in personal allowances until the outcome of the consultation on the need to broaden Hong Kong's tax base, including the possible introduction of a Goods and Service Tax (GST), is concluded. To do so would be premature and unwarranted in the current environment.



There are, however, a number of revenue raising measures and changes which the Chamber believes the Government should push forward in the forthcoming budget. In particular:

- (1) The Chamber continues to believe that the replacement of the present system for determining duties on alcohol with a specific duty, as described in our submission responding to the "Duty on Alcoholic Beverages - Consultation Document" issued in December 2004 would be of significant benefit to Hong Kong's tourism and hospitality industries.
- (2) Hong Kong lags far behind other developed countries in the use of fiscal measures to discourage smoking, with the last increase (from HK\$766 to HK\$804 per 1,000 sticks) taking place in 2001. In this regard, the Chamber still supports a progressive increase in duty rates on tobacco products on public health grounds, although we appreciate that whilst increases in the duty would help promote health objectives it may also encourage some people to turn to illicit cigarettes, and measures would need to be taken to combat this. We are pleased to note that the Legislative Council has now passed the Bill aimed at discouraging smoking in public areas.
- (3) In last year's submission we noted our understanding that the SARG was intending to consult with the general public in order to identify the appropriate level of hospital fees and possible financing options by the end of 2005 or early 2006. We are disappointed that this has not yet happened.
- (4) As we have noted in previous submissions, further measures to promote retirement savings amongst both the lower paid, and by taxpayers, should be considered. For the latter, additional benefits should be conferred on pension contributions as follows:
 - a) Voluntary additional lump sum or one-off employers' contributions should be deductible for tax purposes when made. Currently, such contributions are deductible over a 5-year period at 20% per annum. An enhancement in the relief available would encourage more voluntary contributions by employers;
 - b) An increase to the tax deductible limit for voluntary employee contributions to MPF schemes. This will encourage employees to contribute more to their MPF schemes and promote a culture of saving for retirement by individuals.



Expenditure measures

During the years since 1997 there have been comments about the overall cost of government as a percentage share of the GDP of Hong Kong. This reached a high point in 2001, amounting to 22% of GDP. In his 2004/05 Budget, the Financial Secretary set out to reduce this to around 17-18% by 2008, a target that has been achieved ahead of time thanks in part to the strong growth in GDP that Hong Kong has enjoyed over the last few years. It is, however, the view of the Chamber that there is still room for further sensible economies which will not inhibit the process of day-to-day government.

Further, in examining the overall pattern of government expenditure over the past decade the Chamber recognises that for a major part of that time there were special circumstances which came into play as the consequences of the Asian financial crisis were felt by the economy and community of Hong Kong. However, it is important to ensure that some of the special departmental expenditure does not become enshrined in the recurrent expenditure of government.

As a part of any process of reviewing ways in which the SARG could reduce its overall cost base, it is important that the SARG examines opportunities to reduce its overall involvement in activities that can be performed more cost effectively by the private sector and which will deliver an enhanced level of service to the public. Specifically, as we have noted in previous submissions, the Chamber would continue to urge the SARG to identify suitable projects or services that could be delivered under a PPP model, and to appoint consultants to expedite their implementation. Despite previous endorsement of PPP by the SARG, little progress in adopting it has been made in practice.

Given that some 65% of government expenditure is related to employee costs, the Chamber also puts forward the following observations and recommendations for consideration:

- (1) The current Civil Service Pay Level survey should be concluded and the results thereof shared with the wider community as a priority.
- (2) Whilst we accept the proposition that the civil service should be well compensated, it should be performance related. Any review of the salary costs of the Civil Service should also consider the headcount and grade structure within the civil service and whether any changes to that could also be made to achieve a more efficient structure and organisation.



Section 3: Medium to longer term fiscal challenges and Tax Reform measures

As the SARG is well aware, there are a number of issues which will impose pressures on Hong Kong's fiscal prosperity in the medium to longer term. These include:

- An aging population;
- A low, and declining, birth rate;
- An urgent need to reform Hong Kong's healthcare system and the funding thereof;
- The challenges posed by the problem of the long term unemployed and an increasing trend in youth unemployment; and
- The urgent need to improve Hong Kong's environment (although the Chamber fully recognises that taking steps to help improve Hong Kong's environment is a responsibility that the community as a whole must fully embrace if any significant progress is to be made).

Whilst a detailed commentary on these issues is beyond the scope of this paper, these issues may have a dramatic impact on Hong Kong's fiscal prosperity and requirements. In this regard, the Chamber believes it is right and proper that consideration should be given to ensuring that Hong Kong's taxation regime and sources of Government revenue will be sufficient to meet the SARG's ongoing and future financial commitments.

The Chamber therefore welcomes and supports the Government's public consultation on ways of broadening Hong Kong's tax base to ensure its future prosperity. The Chamber is currently in the processing of obtaining the views of its members on the proposals and questions contained in the Government's consultation documentation issued in July 2006. We will submit our comments in due course once this exercise is completed. At this stage, no conclusions or consensus views have been reached, although we would observe that the focus by many in the community on the possible introduction of a Goods and Sales Tax ("GST") rather than a broader Tax Reform package is possibly not helping the debate on this issue.

The Chamber also believes that the SARG's agenda for Tax Reform should encompass a review of various areas in the administration and interpretation of Hong Kong's tax system. These include:

- (1) A Review of the Inland Revenue Ordinance ("TRO")



As we noted last year, in the Chamber's view, the IRO has become outdated; it is nearly 60 years old and would benefit from an overhaul.

The Chamber still advocates that a complete review/update of the IRO is urgently required. This said, we appreciate that this might pose certain challenges; but believe these have to be tackled and not ignored. Thus, we still fully support the establishment of an Independent Review Body to examine specific issues relating to the IRO. Its members should be experts in the field with no previous involvement in formulating or drafting Hong Kong's tax legislation.

Amongst the areas which the Chamber believes should be reviewed are the following:

a) **Timescale for issuing Tax Assessments** - The IRO currently grants the IRD a period of six years in which to revisit tax assessments. Where a taxpayer has incurred tax losses, the period is unlimited. Members of the Chamber, as well as the taxpaying community at large, have experienced an increasing trend for their tax affairs to be re-examined and reassessed, for the full six year period, in relation to issues considered resolved many years earlier. It is entirely proper that taxpayers who make false claims or who mislead the IRD should be exposed to the risk of later re-examination and re-assessment. But where taxpayers have properly complied with their obligations, they should be protected from unreasonable or spurious assessment and claims for payment of tax on account. The independent review body should therefore address the circumstances in which reassessment may be undertaken and the appropriate period for reassessment based on international best practice.

b) **Update guidance on source of profits** - One of Hong Kong's key attractions to foreign investors is the simplicity of its system of taxation. However, recent case law decisions, and reported Advance Tax Rulings, which appear to be inconsistent with the spirit and intents of Departmental Interpretation and Practice Note ("DIPN") No 21 on the Locality of Profits, coupled at times with what seems to be a selective use of the "totality of facts" test to reject offshore profit claims lodged by taxpayers, have caused undue frustrations among the business community and tax practitioners. For example:-

- The IRD has indicated that it may still seek to tax the profit of a re-invoicing company, even though its operations in Hong Kong are in line with the relevant DIPN 21 provisions, on the argument that the profit represent commission (rather than trading profit) derived from activities performed by the re-invoicing company in Hong Kong.



- Activities such as opening letters of credit and the keeping of books of account in Hong Kong, which used to be regarded as auxiliary to the derivation of trading profits, may be used by the IRD to justify its rejection of offshore trading profit claims notwithstanding that the relevant sales and purchase contracts may have been effected by taxpayers outside Hong Kong.

The lack of sufficient guidance and of a reasonable degree of certainty in the IRD's interpretation and of a fair and consistent application of the tax legislation and principles dealing with source of profits may result in Hong Kong losing its competitiveness as well as tax revenues because:-

- Investors are discouraged from setting up their global operations in Hong Kong for fear of having all their profits potentially being considered as having a source in Hong Kong and fully assessable to Hong Kong profits tax;
- Existing Hong Kong taxpayers decide to shift their operations to other jurisdictions (e.g., Singapore) which offer better tax incentives to encourage investments; and
- More taxpayers use offshore incorporated companies to evade tax.

To address these concerns we would recommend that the IRD should seek to finalise its work on the revision and updating of DIPN 21 at the earliest opportunity.

c) Use of anti-avoidance provisions to challenge legitimate tax planning - Although DIPN 15 has provided assurance that the tax anti-avoidance provisions such as Section 61A will only be used by the IRD to strike down "blatant or contrived tax avoidance arrangements", taxpayers and tax practitioners have noted an increasing tendency of the IRD to seek to apply these sections to commercially legitimate transactions undertaken by taxpayers. This approach not only unfairly penalises taxpayers who undertake tax planning measures to legitimately arrange their tax affairs within the acceptable parameters of the Hong Kong tax legislation, but also potentially encourages the use of "offshore" companies to carry out activities in Hong Kong without properly complying with the existing tax legislation (i.e. by means of non-disclosure), on which we comment further below.

d) Use of IT - Whilst the IRD has announced some initiatives in the extension of the use of IT in receiving Tax Returns and Information from taxpayers, under the Information Systems Strategy "ISS" in terms of the portal for 2008 and as part of the "Digital 21" ESD strategy, this is still



some two years away, and is not apparently going to be mandatory. In contrast, many other tax authorities have moved to digital input of tax information, and paper based tax return systems are being phased out completely. We believe Hong Kong is behind in this area, compared to many other jurisdictions and more emphasis needs to be given to these projects. .

e) Other Areas for Clarification - Other measures to improve the understanding and operation of the Hong Kong tax system would include:

- Formal inclusion of OECD transfer pricing principles into the IRO, or as a minimum the issue of a DIPN to clarify the IRD's views on the application of these principles;
- The introduction of statutory provisions specifying the taxation treatment of trusts; and
- Allowing public access to assessors' manuals.

(2) Review of the operation of the Board of Review.

The Board of Review (the "Board") is an important "check and balance" against unreasonable tax assessments issued by the IRD. Accordingly, it is vitally important that the Board is seen to be independent of the IRD, to act fairly and objectively, and to consider all facts and evidence presented to it by both the IRD and Taxpayer alike. There has been a decrease in the number of Board of Review cases and an increase in the number of cases awarded against the taxpayer/appellant, in the last few years. Perhaps more worrying is a growing perception that the Board is too partisan towards the IRD and may be lacking the necessary objectivity.

Accordingly, the Chamber believes that in conjunction with any review of the IRO, a review of the operations of the Board should also be conducted, perhaps with a view to separating complex technical tax cases to be heard by a different and more specialised body than general tax cases.

(3) Enforcement Measures

A key resource of the IRD in recent years has been the establishment of field audit teams, resulting in significant additional revenue for the SARG that may not otherwise have been collected. The field audit teams impose penalties on taxpayers who have evaded tax. Penalties are normally regarded as a means of encouraging full and timely compliance by taxpayers, providing financial compensation for loss of revenue in delinquent cases, and acting as a deterrent to tax evasion as penalties in such cases are normally punitive and/or involve prosecution. That said, imposing penalties in cases where taxpayers have made inadvertent errors in tax returns, but voluntarily disclosed the errors, can be counter productive, especially



when there is no certainty as to the level of penalty that will be imposed should a taxpayer wish to rectify an erroneous return.

The Chamber continues to believe that a one-time tax "amnesty" would be effective means of inducing increased taxpayer compliance as well as generating additional tax revenue for the Government. Tax amnesties have been successfully applied in numerous other jurisdictions including Austria, Australia, Belgium, Finland, France, Greece, Ireland, Italy, Portugal and Switzerland, and more than half of the states in the USA.

(4) Targeting the use of offshore companies

Despite the presence of field audit teams, tax evasion remains widespread in certain areas of the economy, such as the use of "offshore" companies which operate in Hong Kong but which do not file tax returns. The Chamber would support and encourage the IRD to broaden their attack against tax evasion beyond the taxpayer groups which are already registered with the IRD.

The Chamber is pleased to note that there is some progression in this area – such as the requirement for more disclosure of transactions with offshore related companies in a taxpayer's profits tax return.

Similarly, the new requirement for offshore companies owning Hong Kong property to pay a Business Registration fee and file a Profits Tax Return is helpful. In this regard, the deeming provisions of the new Offshore Funds exemption legislation, which require certain investors in offshore entities to impute and report income of the offshore entity as their own Hong Kong taxable income, may help reduce the number of tax avoidance cases, though, it remains to be seen how many of these potential Hong Kong taxpayers will comply with this requirement.

But more should be done. Whilst there are around 750,000 entities registered under the Hong Kong Companies Ordinance, only some 230,000 of these are believed to be active. Are the remaining entities truly "inactive", and how many of them should be filing Hong Kong profits tax returns and paying Hong Kong taxes? Is this resulting in any serious revenue leakage for the SARG?

(5) The new Offshore Funds Exemption legislation

Related to the disclosure point noted above, it is clear that the IRD expect many Hong Kong based investors in offshore entities, not just properly recognised mutual funds, to deem income from their investment and subject it to taxation in their Hong Kong Tax Returns for 2006/07 and



thereafter, as a result of the enactment of this new tax legislation. Consultation with industry and interested parties on these new disclosure requirements in Hong Kong Tax Returns before the 2006/07 Tax Return are issued would be helpful.

(6) Double Tax Treaties

The Chamber is especially pleased to note the recent signing of the new Double Taxation Arrangement between the Mainland and Hong Kong. We note that there are discussions for Double Taxation Agreements ("DTAs") ongoing with the Czech Republic, Italy, the Netherlands, Macao (this should be progressed more quickly given the conclusion of the new treaty with the Mainland and the proximity of Macau to Hong Kong and the special issues that gives rise to) and Vietnam.

Whilst it appears that progress on negotiations seems to be slowing down, we believe more comprehensive DTAs should be entered into by Hong Kong. Whilst the need for "exchange of information" provisions in any such treaties will present challenges, a broader treaty network would offer significant benefits to Hong Kong and Hong Kong businesses. The United Kingdom, as a major investment partner into Hong Kong is being encouraged to start negotiations for a DTA sooner rather than later, and this is a separate British Chamber initiative.

The new DTA with the Mainland will lend further support to the role Hong Kong can play as the gateway to China and attract investment flows from overseas' markets such as US, Europe, the Middle East, and Russia. The Chamber congratulates the Government on the work it has been doing to put Hong Kong on investors' radar screens. More should be done to strengthen these external links. Similarly, Hong Kong's role as the springboard for Hong Kong and Mainland companies investing overseas will be enhanced if Hong Kong's tax treaty network can be expanded.

(7) Other Tax Reform measures

The Chamber continues to support measures which would modernise Hong Kong's tax system without unduly prejudicing its simplicity. The abolition of Estate Duty and exemption from Hong Kong tax for Offshore Funds in recent years are excellent examples of positive steps in this regard. However, as we noted in last year's submission, the Chamber believes that there is still room for more initiatives in this area, including:



- a) Revamping tax filing and payment deadlines so they are more closely linked to financial year ends;
- b) Introducing 'self assessment', with a view to further improving the efficiency of the IRD;
- c) Charging interest on tax underpayments and repayments, in order to fairly compensate both the SARG and taxpayers where tax is owed by one party to the other after the due date for payment has passed;
- d) Withholding salaries tax withholding at source, allowing for a constant flow of revenue to the SARG over the financial year, and simplification of the tax return and assessment process;
- e) The Chamber was disappointed that in his 2006/07 Budget speech the Financial Secretary ruled out the need for any group loss relief regime or loss carry-back arrangements in Hong Kong. The Chamber still believes that such measures would be welcomed by Hong Kong businesses and would help enhance Hong Kong's competitive position.

Section 4 – Other matters including the Environment and measures to enhance Hong Kong as a Global Financial Centre

(1) Environmental issues

As already noted already, the urgent need to improve Hong Kong's environment will have a dramatic impact on Hong Kong's fiscal prosperity in the medium to long term. Due to its importance and complexity, we would refer to our previous submissions on this topic. However, we would reiterate in this submission that there are a number of measures we believe that the SARG must address in this area as a matter of priority, including:

- a) Greater emphasis and priority should be given to the introduction of "polluter responsibility schemes" including the schemes designed to promote the recovery and recycling of tyres and to reduce the use of plastic bags;
- b) The introduction and enforcement of border emissions testing and substantial spot fines to prevent free entrance into Hong Kong of fuel and commercial and tourist vehicles that do not meet Hong Kong emissions standards;
- c) The introduction and enforcement of severe financial penalties for environmental damage, including increased fines and penalties for any hot air or dangerous gas or other waste or emissions and polluters of the air, harbour and other marine areas;



- d) The encouragement of public and private sector investment in advanced recycling techniques, including tax deductions for individuals or businesses , who spend on environmentally friendly plant and machinery items such as solar panels, windmills, bicycles , air conditioning monitors, insulation, geothermal pumps etc or other energy efficient devices for their homes or businesses. Such tax reliefs are already available at an individual taxpayer level in many countries;
- e) Current trial waste reduction and recycling schemes for household, construction and commercial waste need to be expanded into comprehensive territory-wide schemes, with suitable tax and other incentives, and penalties for non-compliance; and
- f) Investment in schemes to encourage greater energy efficiency across Hong Kong.

(2) RMB banking business

We continue to believe strongly that further development in RMB banking in Hong Kong is important in Hong Kong fulfilling its potential as an RMB offshore centre, and reinforcing its role as an international financial centre. While fully aware, and in agreement, with the gradualist approach adopted by the Chinese authorities in opening its capital account and conducting exchange rate reform, the Chamber believes it is possible to relax some of the existing limits without jeopardising financial stability in mainland China. Possible measures include:

- a) Allowing a greater range of banking products, especially on the lending side;
- b) Enhancing the RMB clearing mechanism in line with product liberalisation;
- c) Raising daily limits on exchange and remittances;
- d) Permitting remittances to more than one registered account in Mainland China;
- e) Promoting the establishment of RMB debt issuance mechanism;
- f) Opening RMB banking services to a broader range of corporate entities.

(3) Becoming China's leading capital and wealth management centre

With China continuing to grow at a rate of 8-10% every year, its need for capital and the speed of wealth accumulation is unprecedented. In 2005 alone, 12 Chinese companies were listed in Hong Kong out of the total of 67 listings. Together a total of USD37b of capital was raised placing Hong Kong at the 4th position in the global ranking for the amount of capital raised in



2005. Hong Kong's performance as a centre for capital raising has been even more impressive and spectacular in 2006.

This trend of more and more Chinese companies coming to Hong Kong to raise funds through our capital markets will continue. It is important that Hong Kong maintains its lion's share in the capital raising game by providing an efficient and transparent regulatory framework, enabling the co-listing of A- and H- shares, and upholding the highest standards of corporate governance for companies raising funds.

In the area of Wealth Management, the recently introduced Qualified Domestic Institutional Investor scheme (QDII) by China provides a good opportunity for Hong Kong to capture the offshore wealth management businesses from China.

(4) Education and Training

Education and training remain a concern to Chamber members. In particular, the Chamber believes that the SARG should:

- a) To continue to focus as a priority on ensuring that adequate international schooling is available in Hong Kong. The shortages of places continue to be a major problem for families looking to move or re-locate to Hong Kong. Moreover, many families who have made their homes in Hong Kong are having to look for schooling outside Hong Kong for their children;
- b) To continue to focus resources on promoting the importance of language education in Hong Kong, including within schools, colleges, universities, and companies, with more emphasis on the importance of tri-lingual competence;
- c) Continue to take steps to attract talent from the Mainland (and elsewhere) to work in Hong Kong with a view to reinforcing the quality of our human capital and strengthening ties with the Mainland; and
- d) To continue to put in place measures to help Hong Kong's SMEs flourish and expand. Such measures should include assistance and support for training of employees within SMEs; the Chamber is disappointed to the note that the SME Training Fund which was closed in 2005 has not been reinstated or replaced with a similar incentive.

(5) Information, Communications and Technology



Efficiency of Hong Kong's Technology and communications strategy will continue to be an important driver in contributing effectively to the budget in the future. In particular, the Chamber believes that the SARG should:

- a) Continue with the focus on an improved regulatory framework for telecommunications liberalisation and take advantage of Hong Kong's tax position to become an ICT hub within Asia Pacific.
- b) Continue to focus on measurable objectives for government improvement. The latest Digital21 draft paper is a huge improvement over the 2004 version. The Chamber would like to congratulate the government on the direction it has set and the appointment of a Government CIO is to be applauded. The Chamber will be responding in detail to the draft paper.
- c) Re-design how funding is distributed to SME's in the technology area. The Chamber feels the current system is not working and is causing much negative comment in this segment. The Chamber would like to see a system of seed capital investment for technology SME's based on focussed industry areas, high potential ideas and the easy distribution of funds all linked to measurable business and government efficiency outcomes.
- d) The Chamber would like to congratulate the SARG for technology improvements in enabling government services. The initiatives regarding the government portal and DTTN are to be applauded.
- e) Finally, Establishing the Communications Authority by merging the Broadcasting Authority and Telecommunications Authority upon enactment of the necessary legislation in 2007/8 (subject to the Legislative Council proceedings) is forward thinking. It will be of great benefit to Hong Kong, providing the regulatory framework is aligned and the promotion of enabling technologies such as Wimax, fibre to the home and fixed/mobile converged technologies are actively supported

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