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AmCham: Put off bank tax

The American Chamber of Commerce strongly urged the Government yesterday to defer and reconsider the Inland Revenue (Amendment) Bill, which it said discriminates against banks and financial institutions.

The Bill will levy a 17 per cent profit tax on interest from offshore loans made by banks and financial institutions.

In a letter addressed to the Unofficial members of the Legislative and Executive Councils, the chamber has pointed out that the Bill does not meet certain basic principles of Hongkong's tax system and will give rise to practical difficulties in administration.

The chamber said the Bill violates one of the fundamental requirements of Hongkong's tax system – that tax legislation be equitable.

"It is discriminatory for the Government to levy profits tax on interest from offshore loans made by banks and financial institutions, but not to levy profits tax on offshore earnings of other forms of business."

The chamber believes that the provision by a bank of funds offshore to a borrower located outside Hongkong does not give rise to profits derived from the Colony and should not be taxable.

The Bill does not also take into consideration the different levels and types of activities of banks and financial institutions in Hongkong.

As a result, the Bill may penalise smaller banks which do not have an extensive branch system.

Further, the Bill does not enable banks of any size to determine how much activity by its Hongkong employees will subject its offshore income to tax and how much activity by another branch will constitute 'substantial intervention.'"

The Bill departs from the Budget speech of the Financial Secretary, Mr Philip Haddon-Cave, and recommendations made by the Inland Revenue Review Committee, the chamber said.

Mr Haddon-Cave was concerned that interest on loans are remitted back to Hongkong for use in Hongkong and the loans can be linked to the Hongkong dollar.

But the Bill goes far beyond these concerns in that it seeks to tax interest on loans whether the proceeds are utilised in Hongkong and whether the loan is funded with Hongkong based deposits.

Moreover, the Bill will not necessarily prevent loans linked to the Hongkong dollar from escaping tax by Hongkong. These inconsistencies will lead to further problems for the tax system.

The Bill will make it practically impossible for professional advisers to inform their clients of the manner in which the expected tax will be levied on earnings of offshore loans, and banks

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themselves will find it nearly impossible to determine when the tax is applicable.

Enforcing the legislation will prove administratively burdensome and expensive.

The Bill may subject banks to double taxation, the chamber stated. Many offshore loans to non-Hongkong borrowers are subject to substantial withholding taxes in the country of the borrower. There is no adequate foreign tax credit mechanism in the Hongkong system and, consequently, adding the 17 per cent Hongkong profit tax to income already burdened by foreign withholding taxes on gross income may result in double taxation.

Applicable limitations on foreign tax credits under U.S. law may force many U.S. banks to reconsider the scope of their operations in Hongkong.

The Bill has a retroactive effect which means interest on all loans which have not yet matured as of next month but which were negotiated before the enactment of the Bill will be affected.