HK STANDARD 4 OCT 85

Accountants against proposed tax Bill

PEOPLE are saying

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The Association of International Accountants, Hongkong Branch, has sent to the Standard a copy of the following letter it had sent to the Secretary, UMELCO Ad Hoc Inland Revenue, Review Group, Office of Unofficial Members of the Executive & Legislative Council.

Re: Recent Amendment to the Inland Revenue Ordinance

We are a group of accountants resident in Hongkong holding an accountancy qualification originating in the UK. We have decided to submit our views on the recent draft Inland Revenue (Amendment) No. 4 Bill (hereinafter referred to as the Bill) published by the Government on Friday, 19th July 1985. I am directed by the Committee to submit the following views of our Branch for your kind consideration:-

a) First of all we want to express that we will support any reasonable tax anti-evasion scheme and tax anti-avoidance provision for the benefit of the public revenue. However, we think an individual is legally entitled to minimize his taxes and has a right to save on tax and act tax-wise as in all the advanced countries. (Refer C.I.R. vs. Duke of Westminster in UK).

We would like to emphasise that any measures or provisions for the purpose of anti-avoidance of tax should be equitably devised, clearly defined, certain in interpretation, and easy to administer and such a scheme should not be extended to undermine bona fide activities and cause any unfavourable impact affecting the attractiveness of the economy of Hongkong as a whole.

b) We are strongly opposed to the creation of any unclear, unspecified and non-systematic legislation in principle if it is merely for the purpose of covering some small loopholes in certain less material areas. To be more specific, we do not think it is legislative-wise and thoughtful enough to provide unlimited power to an individual person just for the purpose of providing him with a convenience for administering his duties. We would like to draw your attention to the possible consequences if the person we trust today changes in the future. Would it be likely that the Legislative Council is indirectly providing another handsome package for the future retirement of a senior officer?

Retrospectivity

We noticed recently the tendency of the Inland Revenue Department to apply retrospectiveness. The proposed amendments often affect some of the events which happened in the past and put them in retrospect. In our opinion, such a practice is not fair and equitable to the public and it is against the spirit of law and legislation.

Deviation from the concept of locality

We all understand that the concept of taxation in Hongkong is to tax only the profit (income) derived from (the Colony) Hongkong. We are afraid that the recent Sinolink case would give people an impression that the tax net of the Inland Revenue Department is going to extend beyond the Hongkong Tax Principle of Territory.

We would like to point out that one of the elements of leading Hongkong to be an important financial centre and getting prosperous depends very much on the concept of the Territory of Taxation. The taxation system based on the concept of territories is simple, easy to understand and more certain for ascertainment of taxable liabilities or otherwise so that determination of investment projects could be made expediently and with comfort.

We hope that the Inland Revenue Department would not practise in such a way that would threaten local business investment and lead to most of the foreign funds invested here to be repatriated from Hongkong.

Is the Inland Revenue Department going to introduce the practice of not adopting the International Accounting Standard?

We are very surprised to see that the proposed S17(f) of the Bill drafted in the way that no deduction should be allowed in respect of any provision or reserve to meet any debt or liability which may arise or require to be discharged in the future.

In accounting practice, we are required by the accounting standard of the Hongkong Society of Accountants and the International Accounting Standard that all accountants should apply the concepts of Accrual and Matching Cost with Revenue which are two of the four fundamental concepts for preparing accounts in order to show a true and fair view of the financial position and the profit and loss of a business concern.

The Accrual and Matching Cost with Revenue method takes into account all the expenses corresponding to the income earned in an accounting period irrespective of whether there are some liabilities incurred which have not been paid and some trade debts of the same accounting period which have not been collected.

It is a wrongful act not to take into account a known liability incurred by the business during that financial period because this would mean to over-state of net profit, over-payment of dividends, erosion of cash reserve, leading to liquidity problems and insolvency, more frauds in over-stating profit to cheat outside investors, etc.

We are afraid that if this malpractice is encouraged, there will be more business closures without cash reserves for settling the liabilities payable to the employees by law. Futhermore, if this section is approved, it will be more controversial and misleading to investors because the accounting profit and loss would show too much difference between the taxable profit and tax loss. Also S17(j) of the proposed Bill is unreasonably squeezed cash in the form of tax from the business before the equitable payment to the creditors. We think the S17(j) is not a fair provision since it does not recognise future liability and it does not mention that the corresponding revenue to be collectable in future should be excluded from the tax revenue.

The discretionary power of the Commissioner is too wide and too personal

When we read history, we find that kings and officials under the feudal system often gave out judgement by their own wisdom and experience, not necessarily having regard to the evidences and other circumstances of the case.

By reading the proposed S61A, S61B and S61C of the Bill, it immediately gives us an inference that the discretionary power is going to be as wide as those practices under the ruling of the feudal system. S61A confers upon the Commissioner and the authorised officers working under him almost unchallenging power that all decisions and judgements are only up to his "opinion" and "satisfaction."

We are afraid the power is too wide, too personal, too undefined and would lead to uncertainty, undue worries, too controversial and perhaps possible corruption that would bring about discriminations or undue favouritism by some tax officers.

It would be disastrous if the power given is too loose because it would be difficult to control or administer within the department and would cause uncertainty to the general public. We are also afraid that as time goes by, the proposed bill, if so legislated, would no doubt be used abusively by some over-enthusiastic but inexperienced assessors.

In our opinion, it would be unfair if the proposed S61B of the Bill does not take into consideration of the following points:-

(1) The disallowance of the tax loss belonging to the shareholders of the business would lead to an infringement of personal property. The loss suffered was in fact money lost by the shareholders in the net worth of the business and the tax loss should belong to the shareholders as part of the contribution from return of money invested. The tax benefit, if any, received by the original shareholders would be the pay-back of their unsuccessful investment remains. It is the blood for a dying man.

(2) The disallowance of utilisation of loss would result in prohibiting or hindering the bona fide business rescue for a dying corporation and thus have a very bad effect to the whole economy such as creating unemployment. It is too cruel that total loss suffered by the businessman could not be recovered in part. Even though it is a "sweetener" for the tax revenue, it would be a poison for the economy as a whole.

(3) The changes in shareholdings are so frequent in most corporations it would seem that the proposed sections are trying to cover too wide a scope of business activities. In the case of a public listed Corporation, shareholdings seem to change every day. The Board and Management would have to worry every day what the Commissioner is thinking of this event and whether they should obtain clearance for admitting transfer beforehand, etc. We think this proposal only creates public unrest and loss of confidence in the government. Also this proposal will result in undue increase in cost of administration by the Inland Revenue Department.

(4) If a tax loss is not allowed to be carried forward to new shareholders, it is only fair that the loss may be carried back to the benefit of the original shareholders.

(5) We also support the argument of another school of thought that in the case of a limited company, the shareholders and the company itself are two separate entities. The loss suffered by the company should be owned as one of the intangible assets of the company and the proposed S61B is against the spirit of company law.

We wish you would re-consider the consequences of the proposed amendment to make sure that it would not hinder or undermine the on-going laissez-faire system of all the business economic activities just by collecting a few dollars more revenue from some particular cases which only constitute a very minor sector of the economy. If the Ordinance is to be changed in such a way that it allows no person to be able to have a tax-planning before he invests, could Hongkong continue to be one of the popular financial centres in the world?

For and on behalf of The Committee of The Association Of Int'l Accountants Hongkong Branch

Mr Peter C.K. Lai, Secretary