

# Renovating the tax base: China, Hong Kong and Singapore with a focus on offshore jurisdiction

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# Review

- \* International aspects of the income tax regimes in mainland China and Singapore since the end of the 1970s.
- \* Entire history of contemporary mainland tax
- \* With a view to ‘Renovating the Hong Kong Revenue Regime’

# Hong Kong

- \* Stable and narrow income tax base
- \* Territorial tax jurisdiction
- \* Low tax rates

# Why China and Singapore?

- \* Mainland comparison is highly relevant given Hong Kong's close economic relationship and, to an extent, economic integration into the Chinese economy.
- \* Pressures for convergence?
- \* Singapore very similar to Hong Kong.
- \* both aim to be major offshore financial centres for transnational economic activities

# China

- \* China's tax rules have changed rapidly since 1978.
- \* Major reform occurred in 1991 to 1993 – FIET & DEIT
  - \* Created harmony in domestic but gave differential treatment to foreign
- \* Major reform 2008 – EIT
  - \* Harmonised both

# International Tax Stage 1

- \* Attract, direct and control foreign investment
  - \* Rationale
  - \* Numerous incentives and concessions for FDI etc.
- \* Little concern about offshore activities of domestic
  - \* rationale
  - \* Poor enforcement of offshore base
  - \* No effective management rule
  - \* No CFC or other anti avoidance
  - \* Outcome?
- \* Also deficiencies in incoming anti avoidance and in IIT

# DTAs

- \* None in effect until 1985
- \* Then suited to needs of major capital exporting nations
- \* Network grew rapidly
- \* Now changed and suit China's needs as an investor offshore (jumping ahead)

# Context changed

- \* China took off
- \* Became a thriving economy
- \* Became a leading destination for FDI
- \* Was highly desirable
- \* Chinese domestic interests went offshore
- \* Both big and small

# Problems

- \* Incentives to attract not needed
  - \* Revenue lost
- \* Offshore activities not caught
- \* Round tripping – combines both above problems
- \* Incoming tax avoidance
- \* Challenges decentralised administrative structure

# Stage 2 – New EIT 2008

- \* Harmony between sectors
- \* No incentives for FDI per se
- \* Place of effective management rule
- \* CFC rules
- \* General anti avoidance
- \* Thin cap etc
- \* Further action – beneficial ownership, offshore transfers etc

# Policy in the 21<sup>st</sup> Century

- \* All the above shows China's new direction
- \* Enforcing its base both in relation to incoming and [large] outgoing
- \* DTA changes to suit China outward FDI
- \* At a practical admin level – things aren't always so changed
  - \* Remain focussed on the local tax base
  - \* Incentives still given
  - \* Some EIT rules highly circumscribed

# Singapore

- \* Tax development different to that of China
- \* Different economic contexts in which the respective economies have thrived.
- \* Singapore has changed over same period, not a dramatically but still notably.

# Singapore 1980s

- \* Diverse range of tax incentives designed to encourage and attract a variety of economic activities
  - \* Rationale
- \* Like China
- \* Singapore's incentives were better designed and better administered

# Contrast

- \* Singapore still has incentives, China doesn't – why? Possibilities to discuss:
  1. China was a desirable location for foreign investment and no longer needed incentives to attract business.
  2. The incentives unfairly favoured foreign interests over domestic interests.
  3. The incentive regime was not working due to the difficulty of targeting the correct economic activities.
  4. It was decided that incentives never work.
  5. It was decided that incentives are distortionary.
  6. Related to the above, it was decided that it is better to remove incentives and offer a lower tax rate to all.

# The differences that make a difference

- \* Singapore has far more at stake in attracting forms of foreign business that are sensitive to taxation.
- \* Singapore has had far more success in administering its tax incentives and designing them.
- \* Singapore's policy makers do not share the view that incentives don't work.
- \* Singapore's general tax rates are much lower than China's and this would reduce any distortionary impact.
- \* Also effective management may prevent distortions

# The reason?

- \* Ultimately, distinction results from the high degree of management ability in Singapore and specific focus of Singapore's economic policy.
- \* China's size and diversity make the use of incentives far more difficult.
- \* China's administrative institutions compound this problem
  - \* related to the size and diversity of the Chinese economy.

# The other big difference

- \* Pursuit of the residence tax base appears to be moving in opposite directions.
- \* China has been increasingly pursuing it
- \* Singapore has always had a residence regime although this has been limited by its reliance on the remittance basis of taxation.
- \* Might have expected the claim on residents to grow but has moved the other way.

# Singapore abandons the residence base

- \* Individuals now taxed on nearly no FSI even if remitted
- \* Companies since 2003: foreign branch profits, foreign dividends and foreign service income is all exempt from tax *when remitted* as long as it satisfies the core criteria. These are that:
  - \* The country's headline tax rate is at least 15%,
  - \* The income has been subject to some tax directly or indirectly, and
  - \* The exemption is beneficial.
- \* And can still simply not remit.

# Side note - DTAs

- \* Singapore has a good and longstanding network
- \* So was ahead of China (which has now surpassed it)
- \* Was ahead of HK (which is now gaining rapidly)

# Issues

- \* Why is Singapore going in the opposite direction to China in relation to the residence base?
- \* Why does Singapore bother to keep the bit of residence base it has?

# Why have the residence base?

- \* There is the issue of the cost of enforcing the foreign base versus the benefit.
- \* There is the issue of capital export neutrality.
- \* There is the issue of protecting the source jurisdiction through the adoption of the residence jurisdiction.

# Points

- \* China does not fully enforce its offshore jurisdiction. An injustice? Maybe Singapore better.
- \* Singapore's low tax rates mean that it has less to gain in pursuing this jurisdiction.
- \* CEN – look to the low tax rates
- \* Integrity of source base – again look at rates

# Why Singapore retains its limited claim

- \* Contrast to Hong Kong
- \* Why not simply call it territorial?
- \* One reason: Some integrity impact
- \* Another reason: DTA network
- \* Perhaps it was necessary to allow for DTAs
- \* But: This seems to have changed given HK success?

# Final point: Conflict!

- \* China's trajectory is in stark contrast to HK and Singapore.
- \* In many ways China is trying to stop what HK and Singapore are trying to encourage.
- \* Does China tolerate HK as it needs to support HK ultimately?
- \* Does Singapore just free ride on the above?
- \* HK remains particularly vulnerable to change in mainland tax policy
- \* Singapore as well but it has more 'other business'

# In conclusion

- \* Horses for courses
- \* Some different fundamentals
- \* But we can all still learn from one another
- \* Thanks and questions.