

Taxation Without Representation

The History of Hong Kong's
Troublingly Successful Tax System

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Introduction: The Thunder of History

This book tells the story of Hong Kong's tax system. This is worth doing for several reasons. The first of these is simply that it is impossible to understand why a tax system is as it is, except by understanding how it got to be that way. Secondly, and more importantly, tax history is not merely the history of the tax system but also the history of society generally, cut at a new angle. This way of looking at history was clearly stated by the great Austrian economist Joseph Schumpeter, who put it in these words:

The spirit of a people, its cultural level, its social structure, the deeds its policy may prepare — all this and more is written in its fiscal history... He who knows how to listen to its message here discerns the thunder of world history more clearly than anywhere else.¹

More specifically, the development of modern methods of taxation is obviously one of the most important aspects of twentieth-century history. According to one leading tax historian, it is *the* essential feature of twentieth-century history:

If the eighteenth century was the age of enlightenment and the nineteenth the age of industrialisation, the twentieth may well go down in history as the age of taxation.²

This claim may seem extravagant, but it is actually readily defensible. Without income tax, modern methods of warfare would not exist. Similarly, it is only income tax which has made possible the scale and role of the modern state. The centrality of taxation is perhaps most graphically illustrated by the fact (or, at least, the alleged fact, for it has not been officially acknowledged) that the United States government has formulated plans aimed at ensuring the survival of the country's tax system in the event of nuclear holocaust — for without taxes, the state itself cannot survive.³ Over the last few years, tax history has become something of a growth industry, some of the fruits of which are listed in the bibliography at the end of this volume. But even in Europe and the United States, much remains to be done. The story of Hong Kong's tax system is one which has not previously been told.

Thirdly, while useful research could be carried out into the history of taxation in almost any jurisdiction, Hong Kong is a singularly deserving case, because of the spectacular successes of its tax system. Most strikingly, the burden of taxation in Hong Kong is exceptionally light and yet the government has generally operated at a substantial surplus.⁴ As a result, it has accumulated enormous reserves, often standing at more than twelve months' total government spending. This, in turn, has meant that the interest which the government receives on its reserves is itself an important source of revenue. Moreover, since 1945 Hong Kong has experienced spectacular economic growth; and it is widely supposed that its tax system has been a factor in, or even crucial to, its economic success.

That a government that levies only exceptionally light taxes is able to operate at a surplus is, of course, largely due to the fact that its spending has been relatively very low, yet the Hong Kong people seem more content than other peoples not only with the lightness of the burden, as one would expect, but also, more intriguingly, with the combination of very light taxes and very low public spending. The key to this success seems to be that small and medium incomes are hardly taxed at all and that almost the whole of the burden has always been borne by the relatively affluent. It seems to be for this reason that those with small or middling-sized incomes are tolerant of the very low level of public spending. This is not to say that Hong Kong has achieved perfection. Clearly it has not. In particular, the degree of poverty which persists in the territory is deplorable and the conditions in which a substantial part of the populace lives would be regarded as unacceptable in most other comparably affluent societies. Nonetheless, the broad popular support for the overall state of the public finances is extraordinary, as is the scale of the accumulated reserves.

But these successes are troubling on at least two counts. First, judged by criteria widely regarded as axiomatic, Hong Kong's tax system is grossly flawed: it is inherently inequitable and it permits avoidance and evasion of kinds and on a scale which in other developed jurisdictions would be considered scandalous. Its successes therefore suggest that there may be something wrong with these criteria and the theory surrounding them. Moreover, the peculiar structure of Hong Kong's tax system makes it impossible for the government to effect substantial increases in the territory's famously low rates of tax, even if the people wanted it to do so (or so, at least, the government has maintained). But whether this is a shortcoming is debatable: depending on one's perspective, it might be seen as either an appalling obstruction to the realisation of the popular will, or the Holy Grail of tax system design.

Secondly, the Hong Kong government is, and always has been, undemocratic; and it is troubling that an undemocratic political system should have produced a system of taxation and public spending that seems to enjoy more public support than can be claimed by most democracies. More particularly, Hong Kong's tax history seems to support both the Leviathan hypothesis (advanced, most famously,

by the American economist James Buchanan) and the theory of fiscal constitutionalism (likewise advanced by Buchanan).⁵ The Leviathan hypothesis is that democracy has tended to lead to heavier taxation than voters really want. In other words, some lighter mix of taxation and public spending would have come closer to satisfying voters' preferences than the mix in fact achieved by the democratic process. The fact that Hong Kong's approaches to taxation and public spending appear to enjoy greater popular support than those in most democracies seems to lend weight to the hypothesis.

The theory of fiscal constitutionalism is the theory that, if democracy leads to heavier taxation than voters really want, something ought to be done about it. Whilst the theory as to how Leviathan might be tamed is substantial, most countries have put very little, if any, of it into practice. In this respect too, however, Hong Kong is exceptional: the system of government, the constitution and the tax system itself were all designed with the basic objective of making it difficult for the government to increase taxes, to increase the tax system's progressivity, to increase public spending as a percentage of GDP or to operate at a deficit. Yet many people in Hong Kong appear unaware of this. Equally, advocates of fiscal constitutionalism elsewhere have made little use of what would appear to be an especially useful case study.

A fourth reason for studying the history of Hong Kong's tax system is that it is a "flat tax" system (or, to be strictly accurate, it is, as will be seen, both proportional *and* progressive). Its successes (and its failures) therefore bear directly on the debate over the respective merits of proportional and progressive taxation. More specifically, one of the more important proposals for basic tax reform advanced in the United States in recent years — that of Robert Hall and Alvin Rabushka — is largely based on the Hong Kong tax system.⁶ The actual operation of the Hong Kong system is therefore instructive as to the merits of flat-tax proposals generally and the Hall/Rabushka scheme in particular. Given its remarkable successes, Hong Kong's tax system tends to support the case for a flat tax. More particularly, Hong Kong's tax history suggests that it is possible to design a flat tax in such a way that it enjoys very broad popular support; but that a flat tax might be feasible only at a very low level of public spending. It also suggests, however, that a very low level of public spending might be politically acceptable if paid for by a flat tax which has very generous allowances and which therefore concentrates the burden on the affluent.

Fifthly, the history of Hong Kong's tax system sheds useful light on the political process in the territory and perhaps also on the operation of British colonialism generally. Commentators on Hong Kong's system of government almost all recognise the obvious fact that it is dominated by business interests and they routinely cite the exceptionally low standard and corporate rates of tax (currently 15 percent and 16.5 percent respectively)⁷ as evidence of this dominance. But they ignore the fact that the burden is actually very much *lighter* than these

rates of tax suggest. The main reason for this is that several important categories of income are exempt from tax. In particular, dividends are never taxed (even if the profits out of which they are paid have not been taxed); interest and offshore income of all kinds are generally not taxed; there is no tax on capital gains; and the rules relating to benefits in kind are unusually generous. So too are those relating to deductions and depreciation. These features of the territory's tax system obviously benefit its richer residents. Thus, by concentrating on the rates of tax rather than on the real lightness of the burden, commentators have tended to understate the influence of the territory's business community or, at least, they have supported their case with weaker evidence than is in fact available.

But it is not only, or even mainly, the rich who pay less tax than the rates of tax might suggest. Currently about 65 percent of Hong Kong's workforce pay no tax on their incomes at all, because of the exceptional magnitude of the allowances. Given that there is no general indirect tax (such as GST or VAT or even an old-fashioned sales tax), this means that a substantial majority of the populace pay hardly any tax at all. Of those who are taxed, 99 percent pay not at the flat (and inappropriately named) "standard" rate (15 percent), but at progressive rates which produce a lower liability than would the standard rate. Currently, a couple with two children are not taxed at all unless their combined incomes exceed \$316,000 (US\$40,500) per year; and they are not taxed at the maximum rate (flat 15 percent) unless their combined incomes exceed \$3,286,000 (US\$420,000) per year.⁸ Consequently, the number of Hong Kong people paying tax at 15 percent is less than 1 percent.

Overview

The story of Hong Kong's tax system falls naturally into three main parts and so, therefore, does this book.

I A "Partial" Income Tax: 1939–1952

The first part of the book (chapters 2, 3 and 4) covers the period from 1939 until 1952, during which a system of income tax was first established in Hong Kong. Previously there had been no income tax in the Colony. But in 1939, within weeks of war breaking out between Britain and Germany, the colonial government proposed to establish one for the purpose of funding "gifts" to Britain in support of the war effort. The proposal was naturally for the kind of income tax the government considered normal. That is, there would be a single tax on income as such, and it would cover both the world-wide incomes of persons resident in Hong Kong and also income derived from Hong Kong by persons resident elsewhere. In the event, however, a very different sort of tax system was established. So diverse are the systems of income taxation which exist in the world, and which have

existed in the past, and so divergent are the theories as to how, if at all, income *ought* to be taxed, that to suggest that there is such a thing as a “normal” income tax is inevitably to invite argument. Moreover, to label Hong Kong’s tax system abnormal might seem unreasonably pejorative, given its remarkable successes. Even so, the differences between Hong Kong’s tax system and most others are so basic that to refer to the rest as normal, and Hong Kong’s as not, is the most practical way to proceed. This approach is justified also by the fact that it was routinely taken by those involved at the time the system was established: the senior members of the Hong Kong government and those involved at the Colonial Office in London repeatedly made the distinction between “normal” income taxes (that is, taxes on income as such) and the system they were establishing in Hong Kong, even though British Imperial notions of normality did not necessarily hold in the rest of the world. It is necessary to emphasise, however, that the classification of Hong Kong’s tax system as abnormal is not intended to imply any criticism of it. On the contrary, it is precisely because of its abnormal success that it is especially deserving of study.

In any event, the business community — for whom the Colony had been founded, and in whose interest it was unabashedly run — was opposed to any form of tax on incomes. As a compromise, therefore, there was established instead what was described as “a partial income tax”, which differed from normal income taxes in two basic respects. First, there was no tax on income, as such, at all. Instead, there was a schedular system of three separate taxes on three different kinds of income: property tax was imposed on the rental value of property; salaries tax on income from employment; and profits tax on the profits of business. Secondly, the system was based on the *source* principle, meaning that the three schedular taxes were confined to income originating *in Hong Kong*. Offshore income, in other words, was exempt from tax. The maximum rate of tax was 10 percent, but the allowances were set so high that fewer than 1 percent of the population were required to pay any tax at all. This system was brought into being by the War Revenue Ordinance 1940. It was supposed to be a temporary wartime measure, but after the war it was revived by the Inland Revenue Ordinance 1947. This, too, was supposed to be a temporary measure, pending the establishment of a normal income tax, but it remains in force today and its basic structure remains intact. Because the system of taxation devised in 1940 and revived in 1947 remains largely unchanged, this book devotes more attention to this early period than might otherwise be appropriate.

II More Money Than They Knew What To Do With: 1952–1981

The second period is from 1952 until 1981 and is the subject of chapters 5, 6 and 7. During this period, the colonial government continued to regard the Inland Revenue Ordinance 1947 as profoundly flawed. It worked well enough at low

rates of tax, but was incapable (for reasons explained later in this chapter) of operating at high or even moderate rates of tax. The plan was, therefore, to scrap the schedular taxes and establish a normal income tax as soon as possible and then to crank up the rates of tax. But as noted above, this never happened. The peculiar schedular system devised in 1940 and resurrected in 1947 remained in force, as it does still. The rates of tax were however increased from time to time, though none of these increases was large. Most importantly, in 1966, the corporate rate and the maximum personal rate were increased to 15 percent and in 1975 the corporate rate was increased again to 16.5 percent.

Since its enactment in 1947, the Inland Revenue Ordinance has been formally reviewed three times, by committees conveniently referred to as the First, Second and Third Inland Revenue Ordinance Review Committees, established in 1952, 1966 and 1976 respectively. The process of tax reform (or, at least, the failure to reform) during this period was dominated by the work of these committees. When the First and Second Committees were established, the colonial government was still firmly committed to the original objective — that is, scrapping the schedular system and establishing a normal income tax. By the time the Third Committee was established in 1976, however, it appears that the colonial government had given up hope; and that the real reason it established the Committee was simply to get London off its back, for the British government remained of the view that Hong Kong should have a normal income tax. Indeed, the British government had become increasingly embarrassed at the Colony's peculiar schedular tax system and the consequent lack of a welfare state in a colony plainly able to afford one.

III If It Ain't Broke...: 1981–2009

The third phase of Hong Kong's tax history (discussed in chapters 8 and 9) is from 1981 until the present day. During this period, too, there has been no basic tax reform in the territory. But until about 1981, the Hong Kong government's official position was that a normal income tax would be better than the system provided for by the Inland Revenue Ordinance; since then, the government's position has generally been that it has little to learn from Britain about taxation (except how not to go about it) and that, on the contrary, Britain might do well to learn from Hong Kong.

On 1 July 1997, Hong Kong ceased to be a British colony and became a Special Administrative Region (or SAR) of the People's Republic of China. But this entailed no change in the territory's tax system. On the contrary, the Central People's Government (CPG) in Beijing went out of its way to reassure the Hong Kong people and the world at large that its intention was for the Hong Kong government to continue to operate its tax system and its public spending more or less as before. More particularly, the CPG made clear that there would continue to be a complete separation between Hong Kong's tax system and public finances

and those of the rest of the country. That is, the CPG's intention was (and remains) neither to raise revenue in Hong Kong directly (by imposing its own taxes there) nor to do so indirectly (by requiring the Hong Kong government to contribute to the national finances). Indeed, the Basic Law (Hong Kong's post-1997 "mini-constitution") contains provisions to this effect (mainly article 106). This aspect of the territory's system of governance is sometimes referred to as the "fiscal firewall". Moreover, the CPG has made plain that it has no intention of initiating, or even permitting, a more socialistic approach to taxation and public spending. In the early years of the new millennium, the SAR government proposed to establish a value-added tax (called Goods and Services Tax or GST) so as to finance large cuts in the taxes on business profits and large personal incomes. To date, however, this proposal has come to nothing, because it was opposed not only by the Hong Kong people generally, but also by the business community.

Background

It may be useful, before proceeding further, to provide some background information bearing on the origins, development and operation of Hong Kong's tax system. The remainder of this chapter is devoted to this purpose and is comprised of brief accounts of the following:

1. the distinguishing characteristics of Hong Kong's tax system;
2. Hong Kong's system of government;
3. the Hong Kong government's philosophy of public finance;
4. the Hong Kong government's other sources of revenue;
5. the British Income Tax Act of 1803, commonly called Addington's Act, which served as the model upon which Hong Kong's tax system was based; and
6. the source principle (and more particularly the practice, followed by most British colonies in the early twentieth century, of exempting offshore income from tax).

This material is intended merely to make what follows more comprehensible to readers to whom it is novel. Readers familiar with it might prefer to proceed directly to chapter 2.

The Distinguishing Characteristics of Hong Kong's Tax System

The main features of Hong Kong's tax system have remained largely unchanged since 1947 and are as follows. First, the rates of tax are among the lowest in the world, and the burden is even lighter than the rates of tax suggest. Second, there is no tax on income, as such, at all but, rather, a peculiar schedular system of separate taxes on specified kinds of income: property tax is charged on rents (initially

nominal rental value), salaries tax on salaries and profits tax on profits. Third, offshore income is generally exempt from tax. Fourth, as a result of its schedular structure, Hong Kong's system of income tax is inherently inequitable. The reason for this is crucial to Hong Kong's tax history and therefore requires emphasis. It is that *if different categories of income are taxed separately at progressive rates, the system will necessarily be inequitable, because a person whose income falls exclusively into a single category will be required to pay more tax than one whose total income is the same, but is split among several categories.*

The point is most conveniently illustrated by means of a simplified hypothetical case. Suppose, for example, two tax systems. System A is a normal income tax, charged at 50 percent on all income over \$100,000. System B consists of two separate taxes, one (called profits tax) on business profits and the other (called property tax) on rental income. Profits tax and property tax are both charged at 50 percent on all relevant income (that is, profits and rents respectively) over \$100,000. Now assume two people, Jack and Jill. Each has a total income of \$200,000. Jack's \$200,000 consists entirely of profits. Jill's \$200,000 consists of profits of \$100,000 and rents of \$100,000. Under tax system A, Jack and Jill are both liable for \$50,000 in tax. (The first \$100,000 is exempt; and the second \$100,000 is taxed at 50 percent; $\$100,000 \times 50 \text{ percent} = \$50,000$.) Under system B, Jack's liability is exactly the same; he is liable for \$50,000, as before. The first \$100,000 of his income is exempt, as before; and the second \$100,000 is chargeable to tax (that is, profits tax) at 50 percent, as before. Jill, however, is not liable for any tax at all under system B. Her \$100,000 in profits is entirely exempt, because profits tax is charged only on profits above \$100,000. And her rental income is similarly exempt, because property tax is similarly imposed only on rents in excess of \$100,000. Thus, while Jack pays tax at an effective rate of 25 percent (\$50,000 out of \$200,000), Jill pays none, even though their total incomes are the same.

The fifth distinguishing feature of Hong Kong's tax system is that, according to the government, its inherent inequity makes it impossible to effect substantial increases in the rates of tax, unless the system is restructured by scrapping the schedular taxes and establishing in their place a normal income tax — that is, a single tax on income as such. The reason is that, whilst the inequity has proved tolerable at low rates of tax, substantial increases in the rates of tax would accentuate the inequity and produce intolerable administrative difficulty. Whether the administrative difficulty would really be intolerable has never been put to the test. That is, the government has not attempted to impose tax at rates that it believed would render the system incapable of administration. The point remains, however, that the British government and the colonial government both *believed* that the administrative and political costs of imposing high rates of tax without restructuring the system would be too high to bear.

Sixth, although most of the larger loopholes have been filled, Hong Kong's Inland Revenue Ordinance still permits avoidance and evasion of kinds and on a

scale which in other developed jurisdictions would be regarded as scandalous. Seventh, Hong Kong's Inland Revenue Department has always taken an approach to the administration and interpretation of the Ordinance which, judged against the practices of the tax authorities of other developed jurisdictions, is almost incomprehensibly unassertive. Eighth, the fact that there has been no basic tax reform in Hong Kong since 1947 makes the territory's tax system unusually, perhaps uniquely, stable. This is in marked contrast to the volatility in tax policy seen in other parts of the world, notably the Western democracies, since 1945. Stability is generally seen as an important virtue in taxation and Hong Kong's tax system is in this respect exemplary. Ninth, Hong Kong's tax system is notable for its neutrality, for the kinds of incentives and concessions found elsewhere are conspicuously missing. Neutrality is widely seen as an important virtue in taxation, and in this respect too Hong Kong's tax system is exemplary.

Tenth, although the schedular structure of Hong Kong's system of income tax adds to its complexity, it is nonetheless strikingly simple. The Inland Revenue Ordinance is now much more complex than it was, but it is still only about 200 pages — and it contains not only the substantive law, but also the machinery for its administration: taxpayer's obligations, the Commissioner's powers, appeals procedure, and so on. The tax legislation of most other developed countries is far more complex. For example, New Zealand's Income Tax Act 2007, at about 3,000 pages, is fifteen times the size of the Hong Kong statute. It might be supposed that the successful operation of Hong Kong's skeletal statute must depend upon a correspondingly comprehensive body of case law. It might be supposed, in other words, that the courts must have been called upon to fill in the gaps left by the legislature. But this is not so. On the contrary, one of the most striking features of the case law which has grown up around the Ordinance is its relative simplicity. Once again, simplicity is generally regarded as an important virtue in taxation and in this respect, too, Hong Kong's tax system is exemplary.

Eleventh, Hong Kong imposes far fewer withholding obligations than other jurisdictions. Dividends are simply not taxed, so there is no need of withholding. Nor is there any obligation, in any circumstances, to withhold tax on interest. Likewise, royalties paid to Hong Kong residents are not subject to withholding. Royalties paid to non-residents are subject to the withholding of tax, but generally only at 4.95 percent.⁹ Most importantly, Hong Kong has no PAYE (Pay-As-You-Earn; that is, withholding of tax on income from employment). Consequently, not only self-employed taxpayers but also those in employment are obliged to pay their tax directly themselves.

Finally, although the Inland Revenue Ordinance's schedular structure is unique, much of its wording was copied from the Colonial Office's Model Income Tax Ordinance (a standard-form income tax statute produced in Britain in 1922 and intended for use in the smaller colonies) and the Ceylonese (that is, Sri Lankan) Income Tax Ordinance 1932 (which had both, in turn, made liberal use of words

and phrases which had been tried and tested in Britain and in various other colonies). Consequently, Hong Kong's tax system began as an obviously recognisable, though deviant, relative of other Commonwealth tax systems; and so it has remained. Even now, the Hong Kong government continues to promulgate legislation drafted in a style similar to that of Britain and other Commonwealth jurisdictions and it continues to make sensible use of concepts and wording developed elsewhere. (This is true not only of the Inland Revenue Ordinance, but of Hong Kong legislation generally.) Consequently, Hong Kong has always benefited and continues to benefit from experience gained elsewhere. Moreover, as a result of copying words and phrases used elsewhere, Hong Kong obtained also the enormous benefit of the case law from the United Kingdom and other Commonwealth jurisdictions.

Hong Kong's System of Government

In the early nineteenth century, Britain's interest in China revolved around the opium trade: British traders shipped opium from India to China, and sold it to the Chinese.¹⁰ The trade was conducted mainly from an island situated in the Pearl River at Canton (Guangzhou). In 1839, however, the Chinese, understandably tiring of this state of affairs, seized the stocks of opium held in China by the British opium merchants. The British government, regarding this as an unjustifiable interference with free trade, declared war (sometimes referred to as the First Opium War). The British won this war and the terms of the ensuing peace were set out in a treaty signed at Nanking in 1842. One of these terms was that Hong Kong Island (situated at the mouth of the Pearl River) was ceded by China to Britain "in perpetuity". Thus was established the British Colony of Hong Kong. The objective was to establish a base from which British traders could conduct their affairs — notably selling opium to the Chinese — without being under the control of the Chinese government. The Colony fulfilled this objective very satisfactorily.

In 1860, following the Second Opium War, the Colony was extended to include the adjacent part of the mainland, the Kowloon Peninsula. This too was supposed to be in perpetuity. In 1898, the Colony was extended again to include another 1,000 square kilometres or so of the hinterland and some nearby islands, collectively called the New Territories. This time, however, China did not cede the territory in perpetuity, but merely granted Britain a ninety-nine-year lease.

Hong Kong remained a British colony until 1941, when it was occupied by the Japanese, who attacked it a few hours after Pearl Harbour. In 1945, British rule was restored and the territory remained a British colony from then until 1997, when the lease of the New Territories expired. Hong Kong then ceased to be a British colony and became a Special Administrative Region of the People's Republic of China. The Chinese government promised that Hong Kong would enjoy "a high degree of autonomy" and that its "capitalist system and lifestyle"

would “remain unchanged for 50 years”.¹¹ To date the Chinese government has by and large honoured this promise.

When the British established the Colony in 1842, they provided it with a colonial government in accordance with the mid-nineteenth-century British Imperial norm and this remained basically unchanged almost until the territory was returned to China in 1997.¹² The Colony’s constitution was based on Letters Patent and Royal Instructions issued by the British government in the name of Queen Victoria. There was a Governor, who was appointed by and answerable to the British government, but who enjoyed very considerable latitude in the day-to-day government of the Colony. There were also a Legislative Council and an Executive Council, both of which were comprised of “official” members (senior civil servants plus the general commanding the troops stationed in the Colony) and “unofficial” members (supposedly representing the populace generally, but in fact leading businessmen). Until the mid-1980s — after Britain had agreed to return the territory to China — there was no pretence at democracy: all the members of both councils were appointed by the Governor.

The Governor could legislate only with the approval of the Legislative Council; but since its members were appointed by him, disagreements were rare. (The introduction of taxes on income in the Colony in 1940 and 1947 was controversial, as were the colonial administration’s attempts from 1947 until 1975 to replace the schedular system with a normal income tax. But these controversies were exceptional.) Moreover, the Governor controlled a majority (because the official members outnumbered the Unofficials). The government — by which, in Hong Kong parlance, is meant the administration headed by the Governor (since 1997, the Chief Executive) — could therefore legislate at will, if need be. The Executive Council was purely advisory; it had no formal power whatever. In practice, however, the Executive Council was the more powerful body. It met in private and functioned as a kind of cabinet, except that its unofficial members did not even pretend to accept responsibility for the government’s actions. The Governor rarely disregarded the Executive Council’s advice; and the Legislative Council almost always endorsed whatever the Governor and the Executive Council proposed. Thus, the government very rarely proposed legislation publicly unless it had already procured the Executive Council’s approval; and once a proposal had the Executive Council’s approval, it was very rare for the Legislative Council not to go along with it. Consequently, until about 1980 the proceedings of the Legislative Council were generally non-confrontational and have been described as resembling “the ritual of a church service”.¹³ There was no debate in the normal sense, for disagreements were rare and, when they did occur, were “normally over detail, not fundamentals”.¹⁴

Over the course of the latter half of the twentieth century, the Legislative Council was gradually expanded from about twenty members to about sixty. The Unofficials eventually outnumbered the Officials and the Chinese outnumbered

the non-Chinese. By the 1970s, it had become apparent that on the expiry of the lease of the New Territories in 1997, Britain would have no practical alternative but to surrender the whole of the Colony to China. This was formally recognised in 1984, by means of an instrument called the Joint Declaration, the parties to which were the British government and the Chinese government; the Hong Kong people were neither a party to the decision nor even consulted about it. Having agreed to return the Colony to China, however, the British decided to introduce a modicum of democracy there. The number of official members in the Legislative Council was gradually reduced to zero and about half of the Legislative Council's members were elected by geographical constituencies roughly in accordance with international norms, though rather seriously gerrymandered. The rest were elected by what were called "functional" constituencies. For example, the legal profession had its own representative, as did the banking industry, and so on. The functional constituencies were organised so as to preserve the overwhelming dominance of the territory's business interests. Moreover, even this semblance of democracy was confined to the Legislative Council; the selection of the Governor and of the members of the Executive Council remained, as before, wholly undemocratic. Although the changes in the composition of the Legislative Council hardly amounted to democracy, they produced a marked change in the nature of the Council's proceedings. The tone of debate was enlivened considerably and the Council frequently held the government to account in a far more rigorous manner than previously. It also occasionally declined to pass legislation proposed by the government. But the Legislative Council was confined to a role of permanent opposition, for the colonial constitution provided for no means by which it could itself form a government.

The return to Chinese rule in 1997 entailed very little change in Hong Kong's system of government. The territory's constitution is now contained in an instrument called the Basic Law, which is itself subordinate to the Chinese constitution. The Basic Law provides for a Chief Executive rather than a Governor, and he is elected by a committee dominated by Beijing-friendly businessmen rather than appointed directly by London. The functions of the Chief Executive, however, are virtually the same as those previously exercised by the Governor. The Executive and Legislative Councils likewise remain much as before, though the latter's functional constituencies have become even less democratic than in the last few years under British rule. The Executive Council is still appointed by the Chief Executive; it still meets in private; and its function appears unchanged. Prior to 1997, the Colony's highest court was the Privy Council, but it was obviously unacceptable to the Chinese government for an organ of the British government to exercise judicial authority in the SAR. It was therefore necessary for the territory to establish its own supreme court. That title was unavailable, however, because China already had a Supreme Court and any suggestion that the Hong Kong court might rank equally with it was unacceptable to Beijing. The Hong Kong court was therefore called the Court of Final Appeal.

In 2002, the SAR government established a supposedly “ministerial” system of responsibility, in which the official members of the Executive Council are political appointees rather than civil servants, though many of those subsequently appointed were in fact the same people. The significance of this reform remains to be seen. The Legislative Council is still partly democratic (its membership being determined by both geographical and functional constituencies) and both councils are still dominated by the representatives of business. Peculiarly, then, the only substantially populated place in the world whose government is still based on the nineteenth-century British colonial model is Hong Kong — a corner of a rising superpower whose central government still operates along Leninist lines.

The Hong Kong Government’s Philosophy of Public Finance

Hong Kong was colonised for the purpose of functioning as a trading station from which British traders could conduct their affairs — mainly selling opium to the Chinese — free from the control of the Chinese government. The traders wanted somewhere to store their stocks of opium where they would be safe from confiscation, but they also wanted to be free of other aspects of Chinese administration, such as taxes. In some British colonies, it was claimed that colonisation was partly for the benefit of the colony’s indigenous people,¹⁵ but in Hong Kong no such pretence was made.¹⁶ Rather, the reason for choosing Hong Kong, rather than some larger territory, was precisely that the original populace was so small that it could be ignored. Moreover, the Colony was intended *only* as a trading station; it was never intended to populate it with Britons, or to colonise large areas of the hinterland.

Given that the Colony was established for the purpose of trade, the traders naturally regarded it as axiomatic that they should be taxed no more heavily than was absolutely necessary to enable it to function satisfactorily as a trading station. Indeed, they tended to maintain that the cost of running the Colony should not be borne by themselves at all, but by the British government, since their trading activities were (they said) obviously advantageous to Britain as a whole. In the beginning, at least, the colonial government accepted this premise also. So, too, did the Chinese traders who established themselves in the Colony. From the beginning, the British traders, the Chinese traders and the Hong Kong government accepted as an article of faith that increasing taxes any more than absolutely necessary would hurt the Colony’s economy. It is not surprising, therefore, that Hong Kong was somewhat slower to tax incomes than some other British colonies.

As time passed, however, the colonial Hong Kong government came to base its legitimacy on its claim that its aim was to promote the interests of the Hong Kong people generally. Especially after 1945, it was difficult to justify British rule even on that basis. But be that as it may, the colonial government maintained, in accordance with its claim to govern in the interests of the Hong Kong people,

that the exceptionally low levels of taxation and public spending were, indeed, in the collective interest. As one would expect, the business community agreed. The extent to which the Hong Kong public took the same view is unclear, though there has always been, and is still, very little expression of radical dissent. In other words, the range of public debate on the appropriate level of taxation and public spending in Hong Kong is peculiarly narrow. There is much quibbling over detail, but virtually no discussion of the possibility that Hong Kong might raise the level of taxation and public spending to match, say, Singapore or Taiwan, let alone Japan or the West. The government naturally interprets the absence of dissent as approval, but it might also be due to the lack of democracy and the consequent futility of expressing contrary views.

The contention that exceptionally light taxation is in the public interest is based, first of all, on the proposition that high taxes impair economic growth and, secondly, on special pleading to the effect that increased taxes would be even more damaging in Hong Kong than elsewhere, because of certain unique features of the territory's economy. In particular, Hong Kong is extraordinarily dependent on exports. The territory is also therefore peculiarly, perhaps uniquely, dependent upon the ability of its firms to compete in international markets. This in turn means that the economy as a whole is peculiarly sensitive to increases in costs to firms. Therefore, concludes the official view, taxation, as one such cost, must be kept as low as possible.

It would be out of place to attempt here a systematic assessment of the official line of reasoning, but equally it would be remiss not to make a few simple observations as to matters which bear on its validity. It is of course universally assumed that increases in taxation at some point discourage growth. Moreover, the Hong Kong government would seem to be on very strong ground in supposing that the territory's economy is likely to be especially sensitive to increases in taxation. It does not follow from these premises, however, that *any* increase in the exceptionally low level of taxation in Hong Kong would have had a negative effect on the economy. The government has understandably tended to point to the territory's own stellar economic performance as evidence of the benefits of exceptionally light taxation, and to Britain's relative economic decline as evidence of the disastrous consequences of high taxes. This proves little, however, other than that the very high levels of taxation sometimes prevailing in Britain (as high as 98 percent in 1978)¹⁷ could have contributed to a decline that might have happened anyway.

Moreover, experience elsewhere suggests that an increase in the rates of tax in Hong Kong might not have produced any measurable effect on the economy. Of the comparatively small number of economies whose performance since 1945 has matched Hong Kong's, virtually all were taxed more heavily: for example, Singapore, Taiwan and South Korea, let alone Japan, Germany and the United States. It is worth noting also that the rates of tax in Hong Kong have

been raised from time to time, but none of these increases seems to have had any negative effect: despite dire warnings from the Colony's business interests, the miraculous economic boom continued more or less unabated. Of course, economists claim to be able to predict the effects of changes in taxation by much more sophisticated analysis than this, but the Hong Kong government seems not to have made the attempt. According to one unofficial attempt, however, "it seems difficult to believe that an increase in the standard rate of profits tax from the present rate of 15 percent to say, 25 percent, would bring about a noticeable reduction in the volume of investment".¹⁸ The Hong Kong government, however, has simply assumed that high taxes would impair growth. The official line assumes also that Hong Kong's remarkable economic growth has been to the benefit of the populace generally. The assumption is sound. There is still in Hong Kong very considerable relative poverty, and many people live and work in conditions which, in other comparably affluent societies, would be regarded as unacceptable. Nonetheless, the general standard of living in Hong Kong has plainly improved dramatically since 1945. Indeed, it is possible that the lot of the ordinary Hong Kong resident has improved more markedly over this period than that of his counterpart anywhere else in the world.

It is also possible that increased taxation on Hong Kong's more affluent people, even if it impaired the growth of the economy, would nonetheless benefit the majority. In other words, the majority might gain by sacrificing growth, to some extent, for a more equal distribution of wealth. This is an awkward point for the territory's government. Occasionally the government has addressed the argument directly, by simply denying it. That is, the government has maintained that increasing taxes on large incomes so as to increase public spending to improve the lot of the majority would fail to achieve that objective. It has sometimes even maintained that increasing the rates of tax would so damage the economy that it would not produce any increase in revenue.¹⁹ But the government seems to have offered no evidence in support of these propositions, and they seem implausible. No doubt there is a point at which increasing taxes on the rich so as to finance spending on the poor will so damage the economy that the poor will suffer as a result; but it seems clear that Hong Kong has never come close to that point. No doubt it is true also that at some point increases in taxation will actually result in decreases in revenue; but the contention that Hong Kong is anywhere near this point seems absurd. Even Sir John Cowperthwaite, who served as Hong Kong's Financial Secretary from 1961 to 1971 and is generally regarded as the leading theoretician of the territory's low-tax policy, thought it would be possible to increase the standard rate of tax to 20 percent without adversely affecting the territory's economy — though how he arrived at 20 percent, he did not explain.²⁰

The Hong Kong Government's Other Sources of Revenue

To put Hong Kong's system of income tax into context, it is necessary to say a little about the government's other sources of revenue. Like most governments, Hong Kong's relies not only on taxes on income, but also on a variety of other taxes, duties, fees and charges. These include stamp duty (on transfers of land, buildings and shares) and rates (a tax imposed on the occupiers of land and buildings). For most of the territory's history, there was also an estate duty but this was abolished, or at least suspended indefinitely, in 2005. There is no VAT or GST and no general sales tax, but there are duties on various specified categories of goods, such as, notably, petroleum products and motor vehicles. Liquor, tobacco and gambling are taxed also.

In addition to taxes, the Hong Kong government has always relied heavily on charges for the goods and services it provides (such as water) and for the licences it grants, such as drivers' licences and banking licences. Indeed, the Hong Kong government sought to recover the full cost, including capital expenditure, of supplying goods and services long before it became fashionable elsewhere.²¹ Again, the water supply is a good example. In the case of licences, the government typically aims not only to cover its costs, but to make a profit or, to use the government's own jargon, to load licence fees with a tax component. Drivers' licences and banking licences are examples of this practice, also.

Another important source of revenue is land sales. The total land area of Hong Kong is 1,092 square kilometres and the population is about 7 million. Land is therefore extremely valuable and from the time the territory was first colonised the government has made effective use of the opportunities for revenue-raising this value affords. Virtually all the privately held land in Hong Kong is held on lease from the government (the only freehold being St John's Anglican Cathedral — the Church evidently got in early). The rents are generally low, but premiums payable on the initial granting of the lease are very high (and usually determined by public auction). Also, the redevelopment of land typically requires the variation of the terms of the lease under which the land is held; and the government typically grants such variations only on payment of a premium. It is widely and reasonably supposed that land premiums are passed on not only to purchasers and tenants of property, but also to consumers generally and that these premiums therefore amount to an implicit tax on land. But who ultimately bears the burden of this implicit tax is a question which, though important, remains to date unanswered.

Finally, no account of Hong Kong's public finances is complete without a mention of the unusual role of the Hong Kong Jockey Club. This is a private club, but the government has conferred on it a monopoly over the only forms of organised gambling that are legal in the territory — lotteries and betting on horse racing and football. The Club makes large profits, which it applies to public and charitable

purposes. In recent times, its donations have totalled on average about \$1 billion per year. The Club is also the largest single taxpayer in Hong Kong — in 2008, it paid profits tax of \$1 billion and betting duty of \$13 billion.

Addington's Act

One might suppose that when taxes on income were introduced in Hong Kong the system might have been copied from Britain. In a sense, this is true. But the schedular system of taxation which was established in Hong Kong in 1940 and which remains intact today was copied not from the system in force in Britain at that time, but from the system of taxation in force there in the *nineteenth* century. More precisely, that system was established in 1803 and finally put to rest in 1909. Since Britain's nineteenth-century tax system served as the model for the system of taxation still in force in Hong Kong today, it is necessary to briefly examine it.

Income tax was first established in Britain by the Income Tax Act of 1799, sometimes called Pitt's income tax after the then Prime Minister, William Pitt the Younger. The tax was needed to finance the war against Napoleon.²² Pitt's was a comprehensive tax, chargeable on "all income of every person residing in Great Britain"²³ and also on certain categories of income derived from Britain by persons resident elsewhere. The Act did not, however, extend to Ireland. As one would expect, it was unpopular, and the opposition it encountered included an argument that Hong Kong's elite were to advance against their government's proposal to tax incomes a century and a half later: that to require a man (the rights of women were not much considered either in Britain in the nineteenth century or in Hong Kong in the mid-twentieth) to divulge the amount of his income is an intolerable invasion of his privacy. In 1776, less than a quarter of a century before income tax was introduced in the United Kingdom, Adam Smith himself observed that such a tax would not be possible, because it would require "such an inquisition" into people's private affairs "as would have been altogether insupportable in a free society".²⁴

In 1799 one opponent of Pitt's proposal put it thus:

This is a horrible war — the rapacity and greed of the Government go beyond all limits ... it is now actually proposed to place *a tax on incomes!*...
It is a vile, Jacobin, jumped up Jack-in-office piece of impertinence — is a true Briton to have no privacy? Are the fruits of his labour and toil to be picked over, farthing by farthing, by the pimply minions of Bureaucracy?²⁵

In 1802, peace was made at Amiens and Pitt's tax was repealed. In 1803, however, the war was resumed. Pitt's successor as Prime Minister, Henry Addington (later Viscount Sidmouth), reinstated the tax on incomes, but refashioned it so as to impose less on taxpayers' privacy. The essential innovation effected by the Income

Tax Act of 1803, usually referred to as Addington's Act, was to tax income from different sources separately. This was achieved by the introduction of the system of schedules still to be found in the United Kingdom's system of income tax.²⁶

The different schedules brought to tax different categories of income. They still do, although the types of income allocated to each schedule have been varied from time to time over the intervening two centuries. Under Addington's original scheme, Schedule A taxed the owners of land and buildings; Schedule B taxed the profits of farming; and Schedule C taxed annuities payable out of public revenues. Schedule D was divided into a number of "cases", as it still is. These covered various important categories of income, including the profits of trade; of manufacturing; and of professions, employments and vocations; and certain types of income arising outside Britain. Schedule E brought to tax income derived from "any public office or employment of profit". There were no gaps between the schedules, since the sixth case of Schedule D provided for the taxation of "any annual profits or gains" not otherwise covered. Addington's income tax was regarded by the courts as one tax, not several.²⁷ But liability was not based on the taxpayer's total income, since income under different schedules was separately assessed, and the tax on it separately paid; and the separate liabilities thus determined were final — that is, they were not subject to any adjustment (either upwards or downwards) in light of the individual's total income or other circumstances.

The purpose of the schedules was to protect taxpayers' privacy: since different forms of income were separately taxed, taxpayers were not required to disclose the total amount of their income. Addington's Act also provided for a convoluted system of administration whereby assessments under different schedules were supervised by different officials. This was intended to make it impossible for the authorities to collate the various components of any taxpayer's income, as returned under the separate schedules, and so to calculate the total. As will be seen in chapter 2, it was ostensibly for reasons of privacy that something similar was adopted in Hong Kong almost a century and a half later.

It transpired, however, that Addington's system had another crucially important characteristic: a schedular system of separate taxes on different categories of income can operate satisfactorily if the rates of tax are low, but not otherwise. Whether it would have been possible to design a workable, schedular system of income taxation with high (or even moderate) rates of tax without referring to individuals' total incomes is perhaps debatable; but both the British government and the Hong Kong government considered the question at length and concluded that it was not possible. The reason has already been stated, but since it is crucial to an understanding of Hong Kong's tax system it may be as well to repeat it: *if different categories of income are taxed separately at progressive rates, the system will necessarily be inequitable, because a person whose income falls exclusively into a single category will be required to pay more tax than one whose total income*

is the same, but is split among several categories. If the rates of tax are low, the inequities inherent in schedular taxation will be small and so may be tolerable. But the higher the rates of tax, the greater will be both the injustice and, consequently, the political cost of administering the system. As Adam Smith put it, “in a light tax a considerable degree of inequality may be supported; in a heavy one it is altogether intolerable”.²⁸

The inequity of the Income Tax Act of 1803 was unproblematic because the rates of tax were very low. All categories of income were taxed at a flat rate of one shilling in the pound (that is, 5 percent) except farming profits, which were taxed at ninepence in the pound (3.75 percent). But Addington’s tax was to some extent progressive: if a person’s total income from all sources was less than £60 per year, he was exempt from tax; if it was more than £60, but less than £150, he paid, but at reduced rates. These reduced rates were progressive; that is, the rate of tax increased as the taxpayer’s income approached £150.²⁹ But to qualify for this relief from the flat rate, he had to disclose the total amount of his income.³⁰ These provisions had important consequences. First, the great majority of the workforce were not taxed on their incomes at all, because their incomes were less than £60 per year. Secondly, most of those who were taxed, were taxed at the progressive rates, because incomes between £60 and £150 per year were more common than incomes over £150. And, thirdly, incomes over £150 per year were taxed at the flat rates mentioned above. In all three respects, as will be seen, Hong Kong’s tax system resembles that established by Addington’s Act in 1803.

In 1815 Napoleon was defeated at Waterloo and the war came to an end. The income tax legislation thereupon automatically expired. From 1816 to 1842 there was no income tax in Britain, but in 1842 Addington’s system was revived intact by the Income Tax Act of that year. This, too, was supposed to be a temporary measure, but there has been an income tax in Britain ever since. The schedules introduced in 1803 are still preserved in the United Kingdom’s current income tax legislation.³¹ Their privacy function disappeared in 1910, however, when the concept of “total income” was introduced.³² In 1909, David Lloyd George, then Chancellor of the Exchequer, delivered his famous “War Budget on Poverty”, in which he proposed to make income tax progressive by introducing a new “super-tax”, to be superimposed, over and above the ordinary income tax, on incomes over £5,000 per year. But this obviously required the identification of those whose incomes exceeded that amount; and that, in turn, necessarily entailed the requirement that taxpayers declare the total amount of their incomes. The mandatory aggregation of income from different sources was therefore necessary as a prerequisite to super-tax. Lloyd George’s proposals became law in 1910 and since then the liability to tax in the United Kingdom (as in most other countries) has always been based on the individual’s total income. In other words, although the schedules themselves have been retained, their original purpose has gone. Thus, when Hong Kong copied Addington’s system in 1940, it was copying something which Britain had discarded thirty years earlier.

The British Empire and the Source Principle

Judged by today's international standards, Hong Kong's exemption from tax of offshore income is peculiar, for income taxes nowadays generally cover the world-wide incomes of persons resident in the taxing jurisdiction and also income derived from that jurisdiction by persons resident elsewhere. But this has not always been so. On the contrary, in the late nineteenth century and the early years of the twentieth, income taxes based on the source principle were the norm throughout the British Empire. For instance, Australia, Canada, New Zealand, India, South Africa and Rhodesia all had income taxes which exempted offshore income.³³ Only the United Kingdom itself seems to have taxed persons resident in the jurisdiction on income derived from outside it. Thus, Hong Kong's exemption of offshore income was far from unprecedented. But by the time taxes on income were introduced in Hong Kong in 1940, source-based income taxes had fallen out of favour elsewhere. For example Australia, which had previously had a source-based system of income tax, extended it to cover offshore income in 1930.³⁴ And when income tax was introduced in Ceylon in 1932, the system then established covered the world-wide incomes of all persons resident in Ceylon and also all income derived from Ceylon by persons resident elsewhere.³⁵

Why Britain's colonies and dominions originally based their income taxes on source alone rather than on both residence and source is unclear, but this approach would appear to have had several advantages. First, residence is a difficult concept to define and this difficulty would have been especially acute in newly established colonies, because of the itinerant lifestyles of many of those who dominated their economies. Secondly, taxing offshore income presents the obvious practical difficulty that the taxing authority will usually be unaware of its existence, unless the person to whom it accrues chooses to disclose it. Again, this difficulty would have been particularly acute in the circumstances of newly established colonies. Last but not least, exempting offshore income from tax saved it from being taxed twice: first in the "source" jurisdiction (the jurisdiction in which the income originated) and secondly in the "home" jurisdiction (the jurisdiction in which resided the person to whom it accrued).

This analysis is supported by the report of a committee established by the British government in 1922 to co-ordinate tax policy in those colonies still governed directly by Britain.³⁶ It was called the Inter-Departmental Committee on Income Tax in the Colonies Not Possessing Responsible Government. "Responsible" government, in this context, meant a government in which the executive was responsible to the colonial legislature. The Committee was "inter-departmental" in that it was comprised of representatives not only of the Colonial Office, but of the British Inland Revenue and the British Treasury also. The colonies themselves were not represented on the Committee, but they were permitted to submit their views to it. The Committee's basic function was to draft standard form income

tax legislation “for the general use of colonial governments”.³⁷ It duly attempted this task and the result, called the “Model Income Tax Ordinance”, was appended to its Report.

The Committee’s main purpose was to resolve the problems of double taxation which had arisen within the British Empire. Consequently, the “first and fundamental question” which the Committee had to address was, it said, the geographical scope appropriate to a colonial tax system. The Committee concluded that “the most appropriate scheme for the colonies generally is one which imposes tax upon income which either has its origin in the colony, or, while having its origin outside the colony, is received in the colony”.³⁸ The Model Ordinance accordingly provided for the establishment of a tax on income “accruing in, derived from, or received in” the colony in question.³⁹

This approach, the Committee explained, offered two advantages. First, it avoided “the difficulties inherent in an income tax code under which the amount to be charged depends in part upon whether the person is resident or non-resident”. Secondly, it reduced “the problems arising out of double taxation of income to comparatively small dimensions”. There appear also to have been doubts as to whether the colonies’ constitutions authorised their governments to tax residents on their offshore incomes.⁴⁰ The Committee did not make the point that to tax income which originates outside the jurisdiction, and is not received in the jurisdiction, presents the obvious practical difficulty that the taxing authority is likely to be unaware of the existence of the income, unless the person to whom it accrues chooses to disclose it. Possibly the reason for not mentioning this was that it might have carried the offensive suggestion that colonials were less law-abiding than Britons. The Committee conceded that there were “attractions in seeking to impose the tax on the incomes of residents in the colony wheresoever arising, and whether remitted to the colony or not”, but concluded that “the complications and difficulties which necessarily accompany this method of taxation are so great that, in the special circumstances of comparatively small communities, it is in the best interests of a colony to limit the scope of the income tax charge to income which arises in the colony or is brought into the colony”.⁴¹

The existing literature seems also not to explain why most of the jurisdictions which had originally exempted offshore income from tax subsequently ceased to do so. Again, however, the reasons seem reasonably self-evident. First, defining the distinction between domestic income and offshore income turned out to be at least as difficult as defining residence, and probably more so. At any rate, it gave rise to much litigation.⁴² Second, and more important, simply to exempt offshore income from tax was far more generous than was necessary to eliminate problems of double taxation — for the consequence of exempting offshore income from tax was commonly that it was not taxed at all, in any jurisdiction. For example, this seems to have been the outcome in *Commissioner of Income Tax v Mehta*,⁴³ in which the taxpayer was resident in India and made profits by speculating in cotton

and silver futures in London, Liverpool and New York, which he did by instructing by telegram brokers in those cities. He was assessed to tax in India, but the Privy Council annulled the assessment on the basis that the profits were derived from outside the jurisdiction. In reaching this decision, the Privy Council dismissed as irrelevant the taxpayer's activities in India, such as exercising skill and judgment, issuing instructions to the foreign brokers, procuring finance for the transactions, and receiving and issuing payments in connection with the transactions. The profits seem not to have been taxed in the United Kingdom or the United States. Third, to exempt offshore income from tax, even if it was not taxed elsewhere, was to encourage taxpayers to arrange their affairs so that as large a part of their income as possible escaped tax altogether. In virtually all the "source" cases to come before the courts, the taxpayer seems to have arranged his affairs with the aim of producing this result.

The fact that other British colonies and dominions once exempted offshore profits from tax is relevant to the history of Hong Kong's tax system for several reasons. First, it was the fact that other British colonies had exempted offshore income from tax that prompted the representatives of Hong Kong's business interests to propose to the Hong Kong government that it should do the same. Secondly, however, it is notable that they managed to persuade the Colony's government to take this approach long after it had fallen out of favour elsewhere. Thirdly, the scope of the exemption was (and remains) wider under Hong Kong law than it would have been if Hong Kong had copied the Model Ordinance. The reason is that Hong Kong's Inland Revenue Ordinance has only ever taxed profits "arising in or derived from" Hong Kong,⁴⁴ whereas the Model Ordinance (and legislation based on it) extended also to income "*received in*" the jurisdiction.⁴⁵ In 1947, the Hong Kong government proposed to extend the charge to cover income "received in" Hong Kong, but the business community successfully opposed the idea. The possibility was considered again in 1976, but was again rejected.

Note on Sources

This book is based mainly on primary sources. The most important of these were the *Hong Kong Government Gazette* (which contains bills and ordinances and various other materials); *Hong Kong Hansard* (which contains the record of the proceedings of the Legislative Council); the reports of the various committees established by the colonial and SAR governments to advise on tax policy; the annual reports of the Commissioner of Inland Revenue; practice notes and other instruments issued by the Commissioner; various series of law reports (some from Hong Kong, some from other jurisdictions); and newspaper archives. The newspaper archives upon which I relied most heavily were those of the library of the City University of Hong Kong and the Department of Political Science at the University of Hong Kong. I also relied heavily on various materials held by the British Public Record Office at Kew and the Hong Kong Public Records Office at Kwun Tong. The most important of these were the series of files at Kew called CO129, which hold the correspondence between the governors of Hong Kong and the Colonial Office in London, together with the Colonial Office's own internal documentation relating to this correspondence. The designation "HKRS...." indicates a file held by the Hong Kong Public Records Office. Copies of many documents in CO129 are also held by the Hong Kong Public Records Office; in such cases, I have generally given the CO129 reference, because copies of CO129 are generally more readily available, even in Hong Kong. Many of the more recent materials are available on the Inland Revenue Department or other Hong Kong government websites. Examples include budget speeches, the documentation relating to the proposed GST and the Department's press releases. I have not supplied full internet citations, because these items are not hard to find and full references would have cluttered up the endnotes. The book is based also on a series of interviews I conducted with a number of persons with long experience of Hong Kong's tax system, including lawyers, accountants, businesspeople and civil servants.

The book's first limitation is that it is based on the public record, supplemented by the secondary literature and a small number of interviews. Much more, therefore,

remains to be done. In particular, it is likely that the archives of some of Hong Kong's larger and older firms (such as Jardine Matheson and HSBC) and of business associations (such as the chambers of commerce) and the personal papers of some of those involved (such as the governors, financial secretaries and prominent businessmen) contain material bearing on the development of the territory's tax system. Also, although the interviews I conducted were invaluable, I interviewed only a very small number of those who are in a position to contribute valuable information and interpretations.

Moreover, even my review of the public record was far from comprehensive. I have examined every file I could find in the series CO129 dealing principally with the taxation of income, but it is likely that I missed some. More importantly, files dealing mainly with other matters (such as public finance generally, other forms of taxation, public spending of all kinds and the political process generally) no doubt contain relevant material; and, although I examined some of these, I undertook no systematic study of them, because this material is too voluminous for it to have been feasible. Also, I have examined only Hong Kong's public record and the Colonial Office's record relating to Hong Kong; there are no doubt other British papers relevant to Hong Kong's tax system, but again it would not have been feasible to attempt to find them. It is likely also that there are public papers in Hong Kong which, despite my best endeavours, I failed to find. Moreover, internal government documentation is generally opened to public access only after the passage of time (usually thirty years, often longer); as the years go by, therefore, more material will be released, and no doubt much of interest will be discovered in it.

Another limitation is that, although I refer repeatedly to the contributions of various individuals (notably governors, financial secretaries, other civil servants and businessmen in Hong Kong; and politicians and civil servants in the United Kingdom) to the development of Hong Kong's tax system, I have only occasionally attempted to go behind or beyond their contributions to the public record. I have also generally dealt with groups (notably Hong Kong's business community) and institutions (notably the Hong Kong government, the British government and the Colonial Office) as entities; I have sometimes differentiated among the individuals of whom they were composed, but I have made no systematic attempt to do so (though I have attached considerable weight to differences in attitude between Chinese and non-Chinese businessmen). Again, the reason is simply that it would not have been feasible. I have also concentrated on matters affecting the long-term development of the tax system, sometimes at the expense of matters regarded at the time as more important. This ordering of priorities is, I hope, appropriate, given that no other book-length account of Hong Kong's tax history has been published, though it leaves much to be done.

Finally, perhaps the book's most serious limitation is that it is based entirely on English-language sources.

Chapter 1 Introduction: The Thunder of History

- 1 Schumpeter (1991), 101 (footnote omitted).
- 2 Sabine (1980), 132.
- 3 Burnham (1989).
- 4 Sources are not cited in this chapter where doing so would merely duplicate citations supplied in other chapters.
- 5 See, for example, Brennan and Buchanan (1980).
- 6 Hall and Rabushka (1995); Rabushka (2000).
- 7 Inland Revenue Ordinance 1947 (as amended) ss 2 and 14 and Schedules 1 and 8.
- 8 Smith and Macpherson (2008), 159.
- 9 Inland Revenue Ordinance 1947 (as amended) ss 15(1)(a) and (b), 20B and 21A.
- 10 On Hong Kong history generally, see Welsh (1997), Carroll (2007) and Tsang (2004).
- 11 Joint Declaration of the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the People's Republic of China on the Question of Hong Kong, 1984, art 3(2) and Annex 1, art 1.
- 12 On Hong Kong's system of government generally, see Miners (1991), Wesley-Smith (1994a) and Ghai (1999).
- 13 Rear (1971), 85. See also Davies (1977).
- 14 Davies (1977), 47.
- 15 Judd (1996).
- 16 Welsh (1997); Carroll (2007).
- 17 Whiteman (1988), 8.
- 18 Owen (1971), 190.
- 19 Sir John Cowperthwaite, *Hong Kong Hansard*, 24 February 1966, 76.
- 20 Sir John Cowperthwaite, 1966 Budget Speech, *Hong Kong Hansard*, 24 February 1966, 77. See also Cowperthwaite's 1970 Budget Speech, *Hong Kong Hansard*, 25 February 1970, 373–374.
- 21 Rabushka (1976); Youngson (1982).
- 22 Dowell (1884); Sabine (1966); Steinmo; (1993); Daunton (2001).
- 23 Income Tax Act 1799 (UK) s 2.
- 24 Smith (1776), V.ii.g.4.
- 25 One John Knyveton, quoted in Sabine (1966), 31, emphasis in original.
- 26 Income and Corporation Taxes Act 1988 (UK).
- 27 *London County Council v Attorney-General* [1901] AC 26, 35–36.
- 28 Smith (1776), V.ii.j.4.

- 29 Income Tax Act 1803 (UK) s 193.
- 30 Income Tax Act 1803 (UK) s 196.
- 31 Income and Corporation Taxes Act 1988 (UK).
- 32 Finance (1909–1910) Act 1910 (UK) ss 66 and 72.
- 33 Littlewood (2004a).
- 34 Baldwin and Gunn (1937), 142.
- 35 Income Tax Ordinance 1932 (Ceylon) s 5.
- 36 *Report of the Inter-Departmental Committee on Income Tax in the Colonies Not Possessing Responsible Government* (1922).
- 37 *Report of the Inter-Departmental Committee*, para 1.
- 38 *Report of the Inter-Departmental Committee*, para 9.
- 39 Model Income Tax Ordinance s 5.
- 40 *Report of the Inter-Departmental Committee*, para 9.
- 41 *Report of the Inter-Departmental Committee*, para 10.
- 42 VanderWolk (2002); Willoughby and Halkyard (1993); Littlewood (2004a).
- 43 (1938) LR 65 IA 332.
- 44 Inland Revenue Ordinance 1947 s 14, as amended.
- 45 Model Income Tax Ordinance s 5 (emphasis added).

Chapter 2 Supporting the British War Effort: 1939–1945

- 1 Miners (1987); Endacott (1964); Endacott (1973).
- 2 This and all other population statistics are from NationMaster.com.
- 3 *Hong Kong Hansard*, 13 October 1938, 116.
- 4 Sir Geoffrey Northcote, letter to Malcolm MacDonald MP (Secretary of State for the Colonies), 6 June 1939, CO129/582/7, 178.
- 5 *Taxation Committee Report* (1939), 83, 89.
- 6 *Hong Kong Hansard*; CO129/582/7.
- 7 *Hong Kong Hansard*, 13 October 1938, 116.
- 8 *Taxation Committee Report* (1939), 86.
- 9 Welsh (1997); Carroll (2007).
- 10 King (1987); Collis (1978).
- 11 Keswick (1982).
- 12 Crisswell (1991), 33.
- 13 This and the following direct and indirect quotations are from *Taxation Committee Report* (1939), 85–102.
- 14 CO129/582/7.
- 15 Sir Geoffrey Northcote, letter to Malcolm MacDonald, 6 June 1939, CO129/582/7, 178; A N (later Sir Arthur) Galsworthy (of the Colonial Office), memorandum, 28 July 1939, CO129/582/7, 2.
- 16 G E J (later Sir Edward) Gent (of the Colonial Office), memorandum, 3 August 1939, CO129/582/7, 4; G E J Gent, memorandum, 2 November 1939, CO129/582/7, 34.
- 17 *Hong Kong Hansard*, 14 September 1939, 120–121.
- 18 Sir Geoffrey Northcote, telegram to Malcolm MacDonald, 28 September 1939, CO129/582/7, 147.
- 19 Sir Geoffrey Northcote, telegram to Malcolm MacDonald, 2 October 1939, CO129/582/7, 142.
- 20 CO129/582/7.

- 21 Malcolm MacDonald, telegram to Sir Geoffrey Northcote, 10 October 1939, CO129/582/7, 137; A N Galsworthy, memorandum, 3 October 1939, CO129/582/7, 12.
- 22 Malcolm MacDonald, telegram to Sir Geoffrey Northcote, 20 October 1939, CO129/582/7, 135.
- 23 Colonial Office minute (author unclear), approximately 3–7 October 1939, CO129/582/7, 15.
- 24 A N Galsworthy, minute, 12 October 1939, CO129/582/7, 27.
- 25 Sir Geoffrey Northcote, telegrams to Malcolm MacDonald, 28 October 1939, CO129/582/7, 113; and 30 October 1939, CO129/582/7, 112.
- 26 Malcolm MacDonald, telegram to Sir Geoffrey Northcote, 8 November 1939, CO129/582/7, 110.
- 27 G E J Gent, memorandum, 2 November 1939, CO129/582/7, 34; minute, 3 November 1939, CO129/582/7, 39.
- 28 Colonial Office memorandum (author unclear, but endorsed by among others MacDonald), 10 October 1939, CO129/582/7, 23.
- 29 *Hong Kong Hansard*, 12 October 1939, 132–135.
- 30 Winston Churchill, letter to General Hastings Ismay (later Lord Ismay), 7 January 1941, quoted in Welsh (1997), 411.
- 31 *Hong Kong Hansard*, 12 October 1939, 140–147.
- 32 “Grand Squeeze”, *SCMP*, 13 October 1939, 1.
- 33 Income Tax Ordinance 1932 (Ceylon) s 5(1).
- 34 *Report of the War Revenue Committee* (1940) (examined below); CO129/582/7; CO129/586/8; CO129/586/9; CO129/589/12; CO129/589/14.
- 35 Income Tax Ordinance 1932 (Ceylon) s 5(1).
- 36 Inland Revenue Ordinance 1947 s 14 (as amended).
- 37 *Hong Kong Hansard*, 9 November 1939, 177–180.
- 38 *Hong Kong Hansard*, 14 March 1940, 25.
- 39 Rear (1971); Davies (1977).
- 40 A L Shields, *Hong Kong Hansard*, 16 November 1939, 200.
- 41 *Hong Kong Hansard*, 14 March 1940, 30.
- 42 This and all other direct and indirect quotations from the 1939 Budget Debate are from *Hong Kong Hansard*, 9 and 16 November 1939.
- 43 The distinctive nature of Chinese firms is the subject of a substantial literature, which seems generally to support the claim that they are especially loth to divulge financial and other information. See for example Redding (1993). By “inner counter” is meant the close circle of senior family members and other associates who alone have access to sensitive information.
- 44 *Hong Kong Hansard*, 9 November 1939, 191. Dodwell here used the word *commission*, but it seems clear that he meant *committee*.
- 45 *Hong Kong Hansard*, 9 November 1939, 195. On d’Almada generally, see Grantham (1965), 99.
- 46 *Hong Kong Hansard*, 16 November 1939, 207.
- 47 CO129/582/7, 105.
- 48 Sir Geoffrey Northcote, *Hong Kong Hansard*, 9 November 1939, 196.
- 49 Malcolm MacDonald, telegram to Sir Geoffrey Northcote, 8 November 1939, CO129/582/7, 110.
- 50 G E J Gent, memorandum, 2 November 1939, CO129/582/7, 35.
- 51 *Report of the War Revenue Committee* (1940), chapter I.
- 52 Crisswell (1991).

- 53 Sir Geoffrey Northcote, letter to G E J Gent, 18 November 1939, CO129/582/7, 102.
- 54 *Report of the War Revenue Committee* (1940).
- 55 Draft War Revenue Bill 1940 cl 60.
- 56 *Hong Kong Hansard*, 7 March 1940, 12–13.
- 57 *Hong Kong Hansard*, 14 March 1940, 22–32.
- 58 *Report of the Second Review Committee (Part II)* (1968), 3 (where, however, Addington is mistakenly referred to as “Addison”).
- 59 *Report of the War Revenue Committee* (1940), chapter II, para 5.
- 60 War Revenue Ordinance 1940 ss 13 and 14.
- 61 *Report of the War Revenue Committee* (1940), chapter II, para 6.
- 62 War Revenue Ordinance 1940 s 6.
- 63 See *Report of the Second Review Committee (Part II)* (1968).
- 64 War Revenue Ordinance 1940 s 28(2).
- 65 *Report of the War Revenue Committee* (1940), chapter II, para 11.
- 66 *Report of the War Revenue Committee* (1940), 11.
- 67 War Revenue Ordinance 1940 ss 13 and 14.
- 68 *Report of the War Revenue Committee* (1940), chapter II, para 3.
- 69 Newport (1939), chapter 18.
- 70 CO129/582/7.
- 71 The Committee’s minutes have been lost, but to some extent the drafting process can be traced from the correspondence between the colonial government, the Colonial Office and the (British) Inland Revenue. See, in particular, Sydney Caine (by this time back in London), letter to Thomas Black (Hong Kong’s Accountant General), 21 March 1940, CO129/586/8, 94; Thomas Black, letter to Sydney Caine, 2 May 1940, CO129/586/8, 159; and K M T Firth (of the Inland Revenue), letter to Sydney Caine, 13 May 1940, CO129/586/8, 153.
- 72 The Model Ordinance used the words “*accruing* in, derived from, or received in” (see chapter 1); but “*arising*” was subsequently substituted for “*accruing*”.
- 73 Draft War Revenue Bill 1940 cls 13 and 14.
- 74 War Revenue Ordinance 1940 ss 13 and 14.
- 75 War Revenue Bill 1940 cls 13 and 14.
- 76 *Hong Kong Hansard*, 18 August 1940, 54.
- 77 War Revenue Ordinance 1940 s 2.
- 78 Willoughby and Halkyard (1993); VanderWolk (2002); Littlewood (2004a).
- 79 *CT v Kirk* [1900] AC 588; *Loveell & Christmas Ltd v CT* [1908] AC 46; *CT v British Australian Wool Realization Association Ltd* [1931] AC 224.
- 80 *CIR v The Hong Kong and Whampoa Dock Co Ltd* (1960) 1 HKTC 85; *CIR v Hang Seng Bank Ltd* [1991] 1 AC 306.
- 81 Thomas Black, letter to Sydney Caine, 23 February 1940, CO129/586/8, 101. This letter recounts verbatim parts of Huxham’s advice to the Hong Kong government. Huxham’s report itself seems not to be held by either the Hong Kong or the British Public Record Office.
- 82 Willoughby and Halkyard (1993); VanderWolk (2002).
- 83 Thomas Black, letter to Sydney Caine, 23 February 1940, CO129/586/8, 101. Emphasis in original.
- 84 Littlewood (1999b).
- 85 See *CIR v International Wood Products Ltd* (1971) 1 HKTC 551; *Sinolink Overseas Ltd v CIR* (1985) 2 HKTC 127; *Exxon Chemical Supply SA v CIR* (1989) 3 HKTC 57; *CIR v Euro Tech (Far East) Ltd* (1995) HKRC 90-074; and *CIR v Magna Industrial Co Ltd* (1997) HKRC 90-082.

- 86 See *CIR v Hang Seng Bank Ltd* (1972) 1 HKTC 583 (the “first” *Hang Seng Bank* case); *CIR v Hang Seng Bank Ltd* [1991] 1 AC 306; and *Wardley Investment Services (Hong Kong) Ltd v CIR* (1993) HKRC 90-068; see also *Bank of India v CIR* (1988) 2 HKTC 503 and *CIR v Orion Caribbean Ltd* [1997] STC 923 (which concerned a subsidiary of the Royal Bank of Canada).
- 87 *Report of the War Revenue Committee* (1940), 12.
- 88 Thomas Black, letter to Sydney Caine, 23 February 1940, CO129/586/8, 101. (In this letter, Black recounted his conversation with the Governor.)
- 89 23 February 1940, CO129/586/8, 101.
- 90 Sydney Caine, letter to Thomas Black, 13 March 1940, CO129/586/8, 97.
- 91 Sydney Caine, letter to Thomas Black, 21 March 1940, CO129/586/8, 94.
- 92 K M T Firth, letter to Sydney Caine, 13 May 1940, CO129/586/8, 153.
- 93 Thomas Black, letter to Sydney Caine, 2 May 1940, CO129/586/8, 159.
- 94 K M T Firth, letter to Sydney Caine, 13 May 1940, CO129/586/8, 153.
- 95 Sydney Caine, memorandum to K Robinson (of the Colonial Office), 31 May 1940, CO129/586/8, 20. Caine here used the word *officials*, but it is clear that he meant *unofficials*.
- 96 War Revenue Ordinance 1940 s 5.
- 97 War Revenue Ordinance 1940 s 2.
- 98 War Revenue Ordinance 1940 s 5.
- 99 War Revenue Ordinance 1940 s 6.
- 100 War Revenue Ordinance 1940 s 6.
- 101 War Revenue Ordinance 1940 s 5.
- 102 For the classic statements of this position, see Haig (1921) and Simons (1938).
- 103 Newport and Plunkett (1958); Whiteman and Milne (1976); Sabine (1966).
- 104 War Revenue Ordinance 1940 Chapter III (ss 8–12).
- 105 War Revenue Ordinance 1940 s 8.
- 106 War Revenue Ordinance 1940 s 8(i).
- 107 *Hong Kong Hansard*, 18 April 1940, 55.
- 108 War Revenue Ordinance 1940 s 8.
- 109 Willoughby and Halkyard (1993); VanderWolk (2002).
- 110 War Revenue Ordinance 1940 s 9(1)(i).
- 111 [1892] AC 150.
- 112 Willoughby and Halkyard (1993).
- 113 War Revenue Ordinance 1940 s 16.
- 114 War Revenue Ordinance 1940 s 9(1)(i).
- 115 War Revenue Ordinance 1940 s 9(2).
- 116 Inland Revenue Ordinance 1947 s 10; Inland Revenue (Amendment) Ordinance 1950 s 3; Inland Revenue (Amendment) (No 2) Ordinance 1975 s 2.
- 117 War Revenue Ordinance 1940 s 12.
- 118 War Revenue Ordinance 1940 s 11(1)(a), (b) and (c).
- 119 War Revenue Ordinance 1940 s 8(iii).
- 120 This was explained some years later by Geoffrey Follows (Hong Kong’s immediate post-war Financial Secretary), *Hong Kong Hansard*, 24 April 1947, 123.
- 121 *Hong Kong Hansard*, 25 February 1970, 366–372.
- 122 War Revenue Ordinance 1940 Chapter IV (ss 13–26).
- 123 War Revenue Ordinance 1940 ss 13 and 14.
- 124 War Revenue Ordinance 1940 s 26.
- 125 War Revenue Ordinance 1940 ss 19, 20 and 22.
- 126 War Revenue Ordinance 1940 s 3(2).

- 127 War Revenue Ordinance 1940 Chapters V to X (ss 27–57).
- 128 Model Income Tax Ordinance s 5(a).
- 129 Income Tax Ordinance 1932 (Ceylon) s 6(1)(a).
- 130 War Revenue Ordinance 1940 s 17(1)(c).
- 131 Nowadays, corporate landlords pay profits tax, rather than property tax, on their rental income: Inland Revenue Ordinance 1947 s 2 (which defines business as including the letting of property by a corporation). Originally, however, this was not so; that is, all landlords were chargeable to property tax, not profits tax, on their rental income (and owner-occupiers were chargeable to property tax, also).
- 132 *Doe dem Wetherell v Bird* (1834) 2 Ad 4 E 161, 111 ER 63; *Fry v Salisbury House Estate Ltd* [1930] AC 432.
- 133 War Revenue Ordinance 1940 s 16(e); Inland Revenue Ordinance 1947 s 17(1)(a) (as originally enacted, see now s 16(1)(a) and (2)).
- 134 War Revenue Ordinance 1941 s 30 proviso (b).
- 135 *Report of the War Revenue Committee* (1940), para 5.
- 136 This illustration ignores the fact that profits tax and salaries tax, but not property tax, would have been assessed on the preceding year basis. Thus, A's liability to salaries tax in 1940 would have been based on his income in 1939, and so on.
- 137 *Report of the Reconstituted War Revenue Committee* (1941).
- 138 *Report of the Reconstituted War Revenue Committee* (1941), para 5.
- 139 *Report of the Reconstituted War Revenue Committee* (1941), para 6.
- 140 *Report of the Reconstituted War Revenue Committee* (1941), para 13.
- 141 HKRS 163-1-448, (1).
- 142 *Report of the Reconstituted War Revenue Committee* (1941), para 7.
- 143 War Revenue Ordinance 1941 s 30.
- 144 Attorney General's "Statement of Objects and Reasons", appended to the War Revenue Bill 1941, *Supplement to the Hong Kong Government Gazette*, 6 June 1941, 447.
- 145 War Revenue Ordinance 1941 s 30(a) and (b).
- 146 War Revenue Ordinance 1941 ss 31–35.
- 147 War Revenue Ordinance 1941 s 30.
- 148 *Studebaker Corporation of Australasia Ltd v CT* (1921) 29 CLR 225.
- 149 *Report of the Reconstituted War Revenue Committee* (1941), para 12.
- 150 Attorney General's "Statement of Objects and Reasons" appended to the War Revenue Bill 1941, *Supplement to the Hong Kong Government Gazette*, 6 June 1941, 447.
- 151 War Revenue Ordinance 1941 ss 5, 14, 15, 16 and 30.
- 152 War Revenue Ordinance 1941 ss 14 and 16.
- 153 Attorney General's "Statement of Objects and Reasons" appended to the War Revenue Bill 1941, *Supplement to the Hong Kong Government Gazette*, 6 June 1941, 447.
- 154 War Revenue Ordinance 1940 ss 13 and 14.
- 155 War Revenue Ordinance 1941 ss 15 and 16.
- 156 Inland Revenue Ordinance 1947 s 14, as amended.
- 157 War Revenue Ordinance 1940 s 2.
- 158 War Revenue Ordinance 1941 s 2.
- 159 Inland Revenue Ordinance 1947 s 2.
- 160 "Table of Correspondence" (between the War Revenue Ordinance 1940 and the War Revenue Bill 1941), *Supplement to the Hong Kong Government Gazette*, 6 June 1941, 448.
- 161 War Revenue Ordinance 1941 ss 10 and 16(iii).
- 162 War Revenue Ordinance 1941 s 46.
- 163 Orow (2000).

- 164 Roxan (1998).
- 165 Freedman (2004).
- 166 *Helvering v Gregory* 69 F 2nd 809 (1934); (1935) 293 US 465.
- 167 Inland Revenue Ordinance 1947 (as amended) s 61.
- 168 *CIR v Howe* (1977) 1 HKTC 936.
- 169 See, for example, *Europa Oil (NZ) Ltd v CIR* [1976] STC 37.
- 170 See Lindsay (1978), Endacott and Birch (1978), Birch and Cole (1982) and Bruce (1991).

Chapter 3 After the War: 1945–1947

- 1 Speech at the Mansion House, 10 November 1942.
- 2 Welsh (1997), 423; Crisswell (1991).
- 3 Welsh (1997), 426.
- 4 *Hong Kong Civil Affairs Policy Directives: Financial Policy*, 7 July 1944, HKRS 211-2-20, (15).
- 5 Author unclear (but perhaps T M Hazelrigg of the Hong Kong Planning Unit), minute to David MacDougall, 8 May 1945, HKRS 211-2-20, 1.
- 6 Welsh (1997), 432.
- 7 Welsh (1997), 430–434; Tsang (2004), 133–157.
- 8 Welsh (1997), 436, 449.
- 9 Tsang (1988).
- 10 *Hong Kong Hansard*, 25 July 1946, 69–77.
- 11 CO129/595/3.
- 12 War Revenue Ordinance 1941 s 73.
- 13 Arthur Creech Jones (Secretary of State for the Colonies), telegram to Sir Mark Young, 2 September 1946, CO129/595/3, 118.
- 14 Welsh (1997), 418.
- 15 Arthur Creech Jones, telegram to Sir Mark Young, 2 September 1946, CO129/595/3, 118.
- 16 This and the following quotes are from *Hong Kong Hansard*, 5 September 1946, 109–129.
- 17 *Report of The Taxation Committee* (1946) HKRS 41-1-802, (1-1). See also CO129/595/3, 106.
- 18 Paton (1985).
- 19 *Report of The Taxation Committee* (1946), para 3.
- 20 HKRS 41-1-802.
- 21 John Fleming, letter to Eric Pudney, 21 October 1946, HKRS 41-1-802, (30).
- 22 See also Acting Financial Secretary, minute to Sir Mark Young, 20 February 1947, HKRS 41-1-2769-1, 1.
- 23 Minutes of the first meeting of the Taxation Committee, 18 September 1946, HKRS 41-1-802, (19-1).
- 24 *Report of The Taxation Committee* (1946), para 1.
- 25 Minutes of the first meeting of the Taxation Committee, 18 September 1946, HKRS 41-1-802, (19-1).
- 26 Littlewood (1998).
- 27 *Report of The Taxation Committee* (1946), para 7.
- 28 *Report of The Taxation Committee* (1946), para 7.
- 29 CO129/595/3.

- 30 Sir Mark Young, telegram to Arthur Creech Jones, 9 September 1946, CO129/595/3, 116.
- 31 Sir Mark Young, telegram to Arthur Creech Jones, 12 December 1946, CO129/595/3, 114.
- 32 Sir Mark Young, telegram to Arthur Creech Jones, 12 December 1946, CO129/595/3, 114.
- 33 Eric Pudney, memorandum, 8 January 1947, CO129/595/3, 29.
- 34 Pudney's Draft Income Tax Ordinance 1947 ("PDITO 1947"), CO129/595/3, 35–103.
- 35 PDITO 1947 cls 43(1)(d) and 20.
- 36 War Revenue Ordinance 1941 s 18(a) and (b).
- 37 PDITO 1947 Chapter VI.
- 38 Eric Pudney, memorandum, 8 January 1947, CO129/595/3, 29.
- 39 Depreciation allowances for commercial buildings were not introduced until later. See now Inland Revenue Ordinance 1947 ss 33A, 33B and 36.
- 40 Eric Pudney, memorandum, 8 January 1947, CO129/595/3, 29.
- 41 Eric Pudney, memorandum, 8 January 1947, CO129/595/3, 29.
- 42 PDITO 1947 cl 5.
- 43 PDITO 1947 Chapter VII.
- 44 PDITO 1947 cls 6, 15, 16 and 29.
- 45 PDITO 1947 cls 13, 14, 42 and 43.
- 46 Eric Pudney, memorandum to Geoffrey Follows, undated, HKRS 41-1-2769-1, (7).
- 47 War Revenue Ordinance 1941 ss 15 and 30.
- 48 War Revenue Ordinance 1941 s 5.
- 49 PDITO 1947 cl 6.
- 50 War Revenue Ordinance 1941 s 16.
- 51 PDITO 1947 cl 16.
- 52 PDITO 1947 Chapter VII.
- 53 PDITO 1947 cl 43.
- 54 PDITO 1947 cl 43(2)(a).
- 55 PDITO 1947 cls 43 and 44.
- 56 PDITO 1947 cl 43(2)(a).
- 57 Inland Revenue Ordinance 1947 s 43.
- 58 Eric Pudney, memorandum, 8 January 1947, CO129/595/3, 29. See also Acting Financial Secretary, minute to Sir Mark Young, 20 February 1947, HKRS 41-1-2769-1, 1.
- 59 A E Emanuel (of the Colonial Office), minute, 20 January 1947, CO129/595/3, 9.
- 60 J B Williams (of the Colonial Office), memorandum to A E Emanuel, 9 January 1947, CO129/595/3, 28; J B Williams, memorandum to Sydney Caine (of the Colonial Office), 16 January 1947, CO129/595/3, 8.
- 61 J B Williams, memorandum to Sydney Caine, 16 January 1947, CO129/595/3, 8.
- 62 Whiteman (1988), 8.
- 63 Eric Pudney, memorandum, 8 January 1947, CO129/595/3, 29, 34.
- 64 A E Emanuel, memorandum, 14 January 1947, CO129/595/3, 7; Arthur Creech Jones, telegram to Sir Mark Young, 26 January 1947, CO129/595/3, 11.
- 65 W D Sweaney (of the Colonial Office), memorandum to A E Emanuel, Ruston and N L Mayle (all of the Colonial Office), 30 December 1946, CO129/595/3, 2; A E Emanuel, letter to D R Serpell (of the Treasury), 23 January 1947, CO129/595/3, 16.
- 66 W D Sweaney, minute, 30 December 1946, CO129/595/3, 4.

- 67 Sydney Caine, memorandum to N L Mayle and J B Williams, 16 January 1947, CO129/595/3, 8.
- 68 N L Mayle, minute, 15 January 1947, CO129/595/3, 7.
- 69 Eric Pudney, memorandum, 8 January 1947, CO129/595/3, 29; A E Emanuel, minute, 20 January 1947, CO129/595/3, 9.
- 70 Whiteman (1988), 8–9.
- 71 A E Emanuel, memorandum, 14 January 1947, CO129/595/3, 6.
- 72 A E Emanuel, minute, 20 January 1947, CO129/595/3, 9.
- 73 D R Serpell (of the Treasury), letter to A E Emanuel (of the Colonial Office), 1 February 1947, CO129/595/3, 15.
- 74 Arthur Creech Jones, telegram to Sir Mark Young, 26 January 1947, CO129/595/3, 11.
- 75 HKRS 41-1-2769-1 (23-1), 5 February 1947.
- 76 Eric Pudney, memorandum to Geoffrey Follows, undated, HKRS 41-1-2769-1, (7).
- 77 Unpublished draft Inland Revenue Bill 1947 (“UDIRB 1947”), CO129/615/2, 202.
- 78 UDIRB 1947 cl 5; Eric Pudney, memorandum to Geoffrey Follows, undated, HKRS 41-1-2769-1, (7).
- 79 UDIRB 1947 cls 6, 15, 16 and 29.
- 80 UDIRB 1947 cls 14 and 44.
- 81 Minutes of the meeting of the Executive Council, 5 March 1947, HKRS 41-1-2769-1, 7.
- 82 *Supplement to the Hong Kong Government Gazette*, 7 March 1947, 306.
- 83 Inland Revenue Bill 1947 as gazetted on 7 March 1947 (“GIRB 1947”) cl 5.
- 84 Acting Financial Secretary, minute to Sir Mark Young, 20 February 1947, HKRS 41-1-2769-1, 1; Sir Mark Young, minute, 22 February 1946, HKRS 41-1-2769-1, 6.
- 85 War Revenue Ordinance 1941 ss 15 and 16.
- 86 PDITO 1947 cls 15 and 16.
- 87 GIRB 1947 cls 15 and 16. Emphasis added.
- 88 GIRB 1947 cls 6, 15, 16 and 29.
- 89 GIRB 1947 cls 9, 14 and 44.
- 90 PDITO 1947 cls 14 and 44.
- 91 GIRB 1947 cl 43.
- 92 GIRB 1947 cls 14 and 44.
- 93 GIRB 1947 cls 9 and 44.
- 94 See, now, Inland Revenue Ordinance 1947 ss 13 and 43.
- 95 Eric Pudney, memorandum to the Financial Secretary, 17 February 1947, HKRS 41-1-2769-1, (8).
- 96 Sir Mark Young, letter to Arthur Creech Jones, 16 May 1947, CO129/615/2, 89. See also Acting Financial Secretary, minute to Sir Mark Young, 20 February 1947, HKRS 41-1-2769-1, 1
- 97 Sabine (1966).
- 98 Eric Pudney, memorandum, 8 January 1947, CO129/595/3, 29, 32.
- 99 GIRB 1947 cl 16.
- 100 Sir Mark Young, letter to Arthur Creech Jones, 16 May 1947, CO129/615/2, 85.
- 101 HKRS 41-1-2776-1; Lo Man Kam, *Hong Kong Hansard*, 1 May 1947, 135.
- 102 HKRS 41-1-2776-1.
- 103 7 March 1947, CO129/615/2, 290.
- 104 *Hong Kong Hansard*, 13 March 1947, 50.

- 105 This and the following quotations are from *Hong Kong Hansard*, 27 March 1947, 68–86.
- 106 Welsh (1997); Judd (1997).
- 107 See Tsang (1988).
- 108 Geoffrey Follows, letter to the Colonial Secretary, 31 March 1947, HKRS 41-1-2769-1, (18); Sir Mark Young, letter to Arthur Creech Jones, 16 May 1947, CO129/615/2, 84.
- 109 Taxation Committee, memorandum, 24 March 1947, HKRS 41-1-2769-1, (18-1).
- 110 Sir Mark Young, letter to Arthur Creech Jones, 16 May 1947, CO129/615/2, 85–86.
- 111 *Report of the Committee Appointed to Examine the Inland Revenue Bill* (“*Morse Report*”), para 1, CO129/615/2, 260.
- 112 *Morse Report*, para 1.
- 113 *Hong Kong Hansard*, 24 April 1947, 119.
- 114 *Morse Report*, para 2.
- 115 *Morse Report*, para 6.
- 116 *Morse Report*, para 11.
- 117 Inland Revenue Ordinance 1947 s 14.
- 118 Inland Revenue Ordinance 1947 (as amended) s 13.
- 119 Inland Revenue Ordinance 1947 ss 13, 14 and 43; see, now, Inland Revenue Ordinance 1947 ss 12B, 13, and 27–33 and Schedule 2. Although the Inland Revenue Ordinance 1947 still provides for these two quite different methods of calculating salaries tax (and, since 1970, personal assessment tax), the highest of the progressive rates is no longer twice the standard rate. See chapters 8 and 9.
- 120 Inland Revenue Ordinance 1947 s 5.
- 121 Inland Revenue Ordinance 1947 s 14.
- 122 Inland Revenue Ordinance 1947 s 14(h).
- 123 Inland Revenue (Amendment) Ordinance 1970 s 8.
- 124 PDITO 1947 cl 44(2).
- 125 GIRB 1947 cl 43(2)(a).
- 126 *Morse Report*, para 20.
- 127 *Morse Report*, “Table of Comparison”, 11; Inland Revenue Ordinance 1947, s 43(1)(e).
- 128 *Morse Report*, paras 8, 10, 14 and 22 and “Table of Comparison”, 10.
- 129 Robert Der, letter to the Secretary, Colonial Office, 10 April 1947, HKRS 41-1-2776-1, (35-2) and (35-3).
- 130 Chinese Anti-Direct Tax Commission, letter to Ronald Todd (Secretary for Chinese Affairs), 21 April 1947, HKRS 41-1-2776-1, (21-1).
- 131 CO129/615/2, 247, 248. See also HKRS 41-1-2776-1.
- 132 Chinese Anti-Direct Tax Commission, Appeal to the Governor of Hong Kong, 24 April 1947, HKRS 41-1-2776-1, (14).
- 133 Unsigned and undated note, HKRS 41-1-2776-1, (15).
- 134 HKRS 41-1-2776-1, (25-1).
- 135 Ronald Todd, minute to the Colonial Secretary (David MacDougall), 28 April 1947, HKRS 41-1-2776-1, 5.
- 136 Inland Revenue Bill 1947, *Supplement to the Hong Kong Government Gazette*, 25 April 1947 (“GIRB (No 2) 1947”).
- 137 *Hong Kong Hansard*, 24 April 1947, 119–124.
- 138 GIRB (No 2) 1947 cl 5.
- 139 GIRB (No 2) 1947 cls 2, 6, 9, 13, 14, 15, 16, 20, 29, 42, 43 and 44.

- 140 GIRB (No 2) 1947 cls 15 and 16.
- 141 GIRB 1947 cls 15 and 16.
- 142 It would presumably be proper, on the basis of *Pepper v Hart* [1992] AC 593, for any court considering the meaning of the words “profits arising in or derived from Hong Kong” to have regard to Follows’s statement (for whatever it is worth).
- 143 Welsh (1997); Coates (1968).
- 144 Willoughby (1977), 53. The “power to destroy” quote is from *McCulloch v Maryland* (1819) 4 Wheat 427, 431.
- 145 Commissioner of Inland Revenue, *Departmental Interpretation and Practice Notes No 21 (Revised 1998): Locality of Profits*, March 1998, para 5(f).
- 146 *Morse Report*, para 22.
- 147 Sir Mark Young, letter to Arthur Creech Jones, 16 May 1947, CO129/615/2, 84.
- 148 Sir Mark Young, telegram to Arthur Creech Jones, 30 April 1947, CO129/615/2, 245; Sir Mark Young, letter to Arthur Creech Jones, 16 May 1947, CO129/615/2, 84.
- 149 *Hong Kong Hansard*, 24 April 1947, 125.
- 150 *Hong Kong Hansard*, 1 May 1947, 134.
- 151 Sabine (1966); Daunton (2001).
- 152 *Hong Kong Hansard*, 1 May 1947, 140–141.
- 153 *Hong Kong Hansard*, 1 May 1947, 142–143.
- 154 *Hong Kong Hansard*, 1 May 1947, 143.
- 155 *Hong Kong Hansard*, 1 May 1947, 156.
- 156 Sir Mark Young, letter to Arthur Creech Jones, 16 May 1947, CO129/615/2, 84.
- 157 *Hong Kong Hansard*, 1 May 1947, 138–139.
- 158 *Hong Kong Hansard*, 1 May 1947, 148.
- 159 *Hong Kong Hansard*, 1 May 1947, 133–134.

Chapter 4 The Governor Goes Native: 1947–1952

- 1 Commissioner of Inland Revenue, *Report of the Commissioner of Inland Revenue for the Year Ended 31 March 1948*, paras 8–11 (CO129/615/3, 16–32).
- 2 1947 Budget Speech, *Hong Kong Hansard*, 13 March 1947, 50.
- 3 Sir Alexander Grantham, letter to Arthur Creech Jones, 18 March 1948, CO129/615/3, 57.
- 4 *Hong Kong Hansard*, 8 March 1950, 50.
- 5 See for example Welsh (1997), Carroll (2007), Wilson (1990), Grantham (1965), Miners (1975), Tsang (1988), Tsang (2004), Youngson (1982), Rabushka (1976), and Lau and Kuan (1988).
- 6 Coates (1968), 5–6.
- 7 Welsh (1997), 450.
- 8 Quoted in Welsh (1997), 449.
- 9 Welsh (1997), 442.
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Chapter 5 A “Horse and Buggy” Statute: 1952–1961

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Chapter 6 Cowperthwaite Is Reined In: 1961–1971

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- 53 *Hong Kong Hansard*, 26 March 1965, 212.
- 54 Inland Revenue (Amendment) Ordinance 1965 s 7.
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- 59 *Hong Kong Hansard*, 24 February 1966, 79.
- 60 *Hong Kong Hansard*, 10 March 1966, 122–125.
- 61 Estate Duty Ordinance 1932 Schedule 1, as amended from time to time.
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- 64 *Hong Kong Hansard*, 24 and 25 March 1966, 209–210.
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- 91 Inland Revenue (Amendment) Ordinance 1969 s 28.
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- 96 *Report of the Second Review Committee (Part II)* (1968), para 8.
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- 98 *Report of the Second Review Committee (Part II)* (1968), Appendix G and para 102.
- 99 Inland Revenue (Amendment) Ordinance 1971 s 9.
- 100 *Report of the Second Review Committee (Part II)* (1968), paras 77–86. See also HKRS 163-9-242.
- 101 *Report of the Second Review Committee (Part II)* (1968), para 80.
- 102 HKRS 163-9-242; HKRS 163-9-245.
- 103 *Report of the Second Review Committee (Part II)* (1968), para 82.
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Chapter 7 Sincere Failure or Successful Charade? 1971–1981

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- 3 Sir Philip Haddon-Cave, 1981 Budget Speech, Table 1, *Hong Kong Hansard*, 25 February 1981, 542.
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- 6 For example, Friedman (1997).
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- 15 Willoughby and Halkyard (1993); VanderWolk (2002); Littlewood (1999a).
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- 26 1976 Budget Speech, para 175.
- 27 Inland Revenue (Amendment) Ordinance 1976 s 2.
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