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Welcome to Tax Flash – RSM Tax Advisory (Hong Kong) Limited's Newsletter Covering Technical Development in Taxation

HONG KONG BUDGET – 2017/18

The Financial Secretary, Mr. Paul Chan, delivered the 2017-18 Budget Speech at the Legislative Council on 22 February 2017.

In this Tax Flash, we set out a summary of the following:-

- ***Economic Performance and Outlook***
- ***Financial Highlights***
- ***Relief and Measures***
- ***Strategy on Developing Economy, Investing for the Future and Enhancing Liveability***
- ***Our Commentary***

1. Economic Performance and Outlook

- GDP grew by 1.9% in real terms and GDP per capita became HK$333,800 in 2016. GDP growth rate is forecasted to be 2 – 3% in 2017. GDP per capita is forecasted to be HK$349,700 – HK$353,000 in 2017.

- Unemployment rate was 3.4% in 2016.

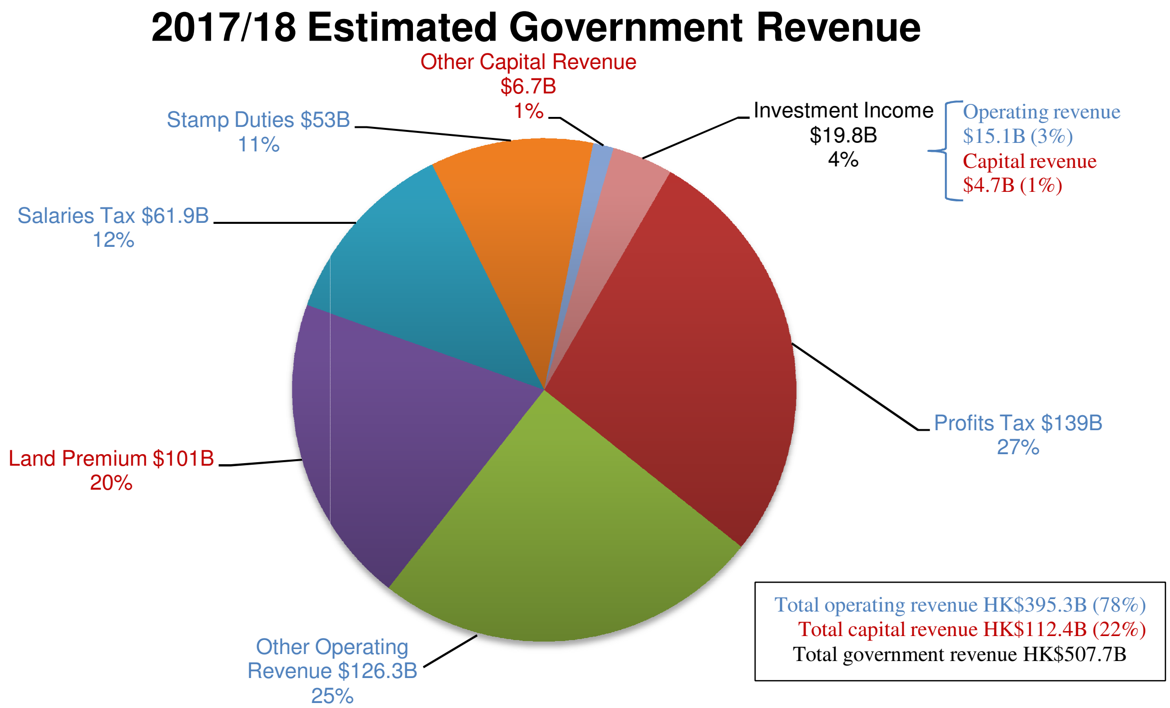
- The underlying average inflation rate was 2.3% in 2016. The underlying inflation rate is forecasted to be 2% in 2017.

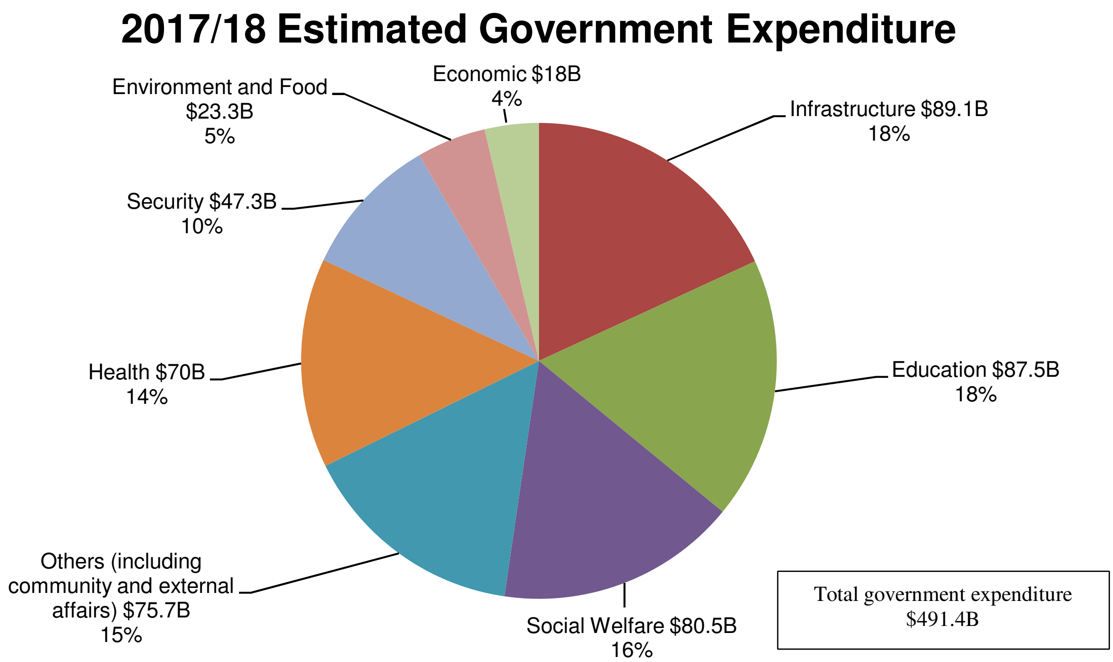
- Hong Kong ranked first globally in terms of funds raised through initial public offerings, which amounted to US$25.1 billion in 2016.

2. Financial Highlights

- A surplus of HK$54.1 billion in the Operating Account and a surplus of HK$92.8 billion in the Consolidated Account are forecasted for the year ending 31 March 2017. By 31 March 2017, the Hong Kong's fiscal reserves will be increased to HK$935.7 billion.

- A surplus of HK$11.1 billion in the Operating Account and a surplus of HK$16.3 billion in the Consolidated Account are forecasted for the fiscal year 2017/18. By 31 March 2018, fiscal reserves are expected to reach HK$952 billion. Breakdowns of 2017/18 estimated total government revenue and total government expenditure are as follows:-





3. Relief and Measures

➢ *Profits Tax*

Comparison Tables on Profits Tax Reduction

	2015/16	2016/17
One-off Reduction	Reduce 2015/16 tax by 75% ceiling @ HK$20,000	Reduce 2016/17 tax by 75% ceiling @ HK$20,000

Comparison Tables on Profits Tax Rate

Tax Rate	2016/17	2017/18
Corporations	16.5%	16.5%
Unincorporated businesses	15%	15%

➢ *Salaries Tax*

Comparison Tables on Salaries Tax Reduction

	2015/16	2016/17
One-off Reduction	Reduce 2015/16 tax by 75% ceiling @ HK$20,000	Reduce 2016/17 tax by 75% ceiling @ HK$20,000

Comparison Tables on Salaries Tax Rate

Tax Rate	2016/17	2017/18
2%	1st HK$40,000	***1st HK$45,000***
7%	2nd HK$40,000	***2nd HK$45,000***
12%	3rd HK$40,000	***3rd HK$45,000***
17%	Balance	Balance
The total tax payable is limited to 15% on net assessable income (before deduction of personal allowances).		

Comparison Tables on the Personal Allowances on Salaries Tax

Personal Allowances	2016/17	2017/18
Basic (Single Person)	HK$132,000	HK$132,000
Married Person	HK$264,000	HK$264,000
Single Parent	HK$132,000	HK$132,000
Child (1st – 9th child)		
Year of Birth	HK$200,000 each	HK$200,000 each
Other Years	HK$100,000 each	HK$100,000 each
Dependent Parent/Grandparent 60+		
Residing Together	HK$92,000 each	HK$92,000 each
Not Residing Together	HK$46,000 each	HK$46,000 each

Personal Allowances	2016/17	2017/18
Dependent Parent/Grandparent 55-59		
Residing Together	HK$46,000 each	HK$46,000 each
Not Residing Together	HK$23,000 each	HK$23,000 each
Disable Dependent	HK$66,000 each	***HK$75,000 each***
Dependent Brother / Sister	HK$33,000 each	***HK$37,500 each***

Comparison Tables on the Deductions on Salaries Tax

Deductions	2016/17	2017/18
Expenses of self-education	HK$80,000	***HK$100,000***
MPF Contribution	HK$18,000	HK$18,000
Home Loan Interest	HK$100,000; 15 Years	HK$100,000; ***20 Years***
Elderly Residential Care	HK$92,000	HK$92,000
Approved Charitable Donations	35% of income	35% of income

- ***Rates***

  Waiving rates for four quarters of 2017-18, subject to a ceiling of $1,000 per quarter for each rateable property.

- ***Miscellaneous***
  - Providing an extra allowance to Comprehensive Social Security Assistance, Old Age Allowance and Disability Allowance recipients, equal to one month of the allowances.

- ***Support measures for tourism industry***
  - Waiving the licence fees for 1,800 travel agents for one year.
  - Waiving the licence fees for 2,000 hotels and guesthouses for one year.
  - Waiving the licence fees for restaurants and hawkers and fees for restricted food permits for one year, benefiting 27,000 restaurants and operators.

4. Strategy on Developing Economy, Investing for the Future and Enhancing Liveability

To withstand the foreseeable tough economic environment, the Government will implement measures in the following areas:-

- ***Supporting Small and Medium Enterprises (SME) and Tourism***
  - Extending the application period for the “Dedicated Fund on Branding, Upgrading and Domestic Sales” for five years to June 2022.
  - Extending the application period for the special concessionary measures under the “SME Financing Guarantee Scheme” to 28 February 2018.
  - Proposing to strengthen the underwriting capacity of the Hong Kong Export Credit Insurance Corporation (“ECIC”) by raising the cap on the contingent liability of ECIC under contracts of insurance from HK$40 billion to HK$55 billion.
  - Allocating an additional sum of HK$243 million in 2017-18 to attract more high-spending visitors and small-and-medium-sized Meetings, Incentive Travels, Conventions and Exhibitions events to Hong Kong.

Promoting Innovation and Technology (“I&T”)

- Reserving HK$10 billion for supporting I&T development in Hong Kong.
- Setting up a new committee on I&T development and re-industrialisation.
- Exploring enhanced tax deductions for I&T expenditure by the tax policy unit.
- Setting up a HK$2 billion Innovation and Technology Venture Fund.
- Enhancing the payment infrastructure by developing a new Faster Payment System.
- Inviting Cyberport to study the latest technology and products development and explore further promotion of e-sports in Hong Kong.

Enhancing Financial Services

- Continuing to explore with the Mainland authorities ways to open up more channels for two-way cross-border Renminbi fund flows.
- Pressing ahead with the work of reforming the regulatory regime for listed entity auditors to make the oversight regime independent from the audit profession.
- Further developing and enhancing the competitiveness of the listing platform in Hong Kong.
- Reviewing the positioning of GEM and examining the feasibility of introducing a new board.
- Issuing a second batch of Silver Bond in 2017-18.
- Enhancing the regulatory regime for combating money laundering and terrorist financing.
- Promoting Hong Kong’s competitive capital market and encouraging the sector to explore opportunities brought by green finance.
- Exploring the development of eMPF to enhance the administrative efficiency and providing room for fee reduction of the MPF Scheme.
- Seeking to expand network of Comprehensive Avoidance of Double Taxation Agreements with other jurisdictions.

Developing Hong Kong into Asia's asset and wealth management centre

- Extending the profits tax exemption to onshore privately-offered open-ended fund companies.

Enhancing Trading and Logistics

- Planning to introduce a bill into the Legislative Council to amend the Inland Revenue Ordinance to offer tax concession for aircraft financing.
- Strengthening the promotion on the development of Hong Kong into a maritime services hub, as well as a platform connecting the Mainland with the maritime industry in other parts of the world.
- Reserving land on both the airside and landside to support the growth in transhipment, cross-boundary e-commerce and high value-added air cargo business.
- Examining facilitation measures to promote air-to-air transhipment in Hong Kong.

Optimising Land Utilisation and Increasing Land Supply

- Estimated potential land supply for private housing in 2017-18 will have 32,000 units.
- Making available for sale of 28 residential sites capable for providing 19,000 units.
- Providing 3 commercial/business sites and 1 hotel sites, capable of providing 172,000 square metres of floor area and 550 hotel rooms respectively.

- Reprovisioning the existing government facilities to release 560,000 square metres of commercial/office floor area.
- Making available for a number of large commercial sites to the market in a few years capable of providing a total of about 1.1 million square metres of commercial floor area.

Improving the Quality of Manpower

- Proposing to inject an additional HK$1.5 billion into the Continuing Education Fund in 2017-18.
- Deploying HK$1 billion for youth development, promoting vocational and professional education and training, facilitating the training and professional development of principals and teachers, and enhancing support for local post-secondary students.
- Allocating HK$300 million to expand the Multi-faceted Excellence Scholarship and the International Youth Exchange Programme.

Improving Livelihood of People

- Examining to provide tax deduction for the purchase of regulated health insurance products.
- Announcing the ten-year hospital development plan of HK$200 billion, under which a new major acute general hospital will be built in the Kai Tak Development Area to provide 2,400 beds and the first neuroscience centre in Hong Kong.
- Earmarking a total of HK$30 billion to strengthen elderly services and rehabilitation services for persons with disabilities.
- Earmarking a total of HK$20 billion for sports development to provide better community and sports facilities for public use.
- Lowering the eligibility age for the Elderly Health Care Vouchers from 70 to 65.

5. Our Commentary

In the 2017-18 Budget, the Financial Secretary forecasts a consolidated budget surplus of HK$92.8 billion for 2016-17, which is significantly higher than the original estimated surplus. The higher than expected revenues from land sales and stamp duty are the main contributors to the substantial surplus. Consequently, the fiscal reserves carried forward are expected to reach HK$935.7 billion by 31 March 2017.

2017 is expected to be a challenging year for the global economy owing to several factors: Donald Trump became the president of the United States and his favour for protectionism may hinder international trade; economic growth of Europe is still constrained by its structural debts; the United Kingdom will withdraw from the European Union; and there are upcoming general elections in some European countries. Domestically, Hong Kong will elect the next Chief Executive in March 2017 which it is not clear if the new leadership could improve the flat economic growth situation.

Generally speaking, the Budget succeeds in addressing several key issues such as developing the economy, improving the people’s livelihood and investing for future. We are pleased that the Financial Secretary continues to offer a variety of measures in further developing the competitiveness of Hong Kong through consolidating the pillar industries and diversifying the development in different industries in particular the innovative and creative industries. The Financial Secretary also reiterates his concern in strengthening manpower and increasing land supply. We welcome that more expenditure will be spent on elderly services and health care in the coming future.

As tax practitioners, we particularly welcome that the Government plans to introduce a bill into the Legislative Council in 2017 to amend the Inland Revenue Ordinance to offer tax concession for aircraft financing. Moreover, while tax legislations have been amended in recent years to allow private equity funds to enjoy profits tax exemption available to offshore funds, we applaud that the Budget proposes to extend the profits tax exemption to onshore privately-offered open-ended fund companies in order to facilitate Hong Kong's development into a full-fledged fund service centre.

The package of measures put forward by the Organisation for Economic Co-operation and Development to tackle Base Erosion and Profit Shifting ("BEPS") is addressed again in the Budget. The Budget reiterates that the Government is actively seeking to expand the network of Comprehensive Avoidance of Double Taxation Agreement with other jurisdictions. The Government is highly recommended to come up with a strategy with a faster pace to respond to BEPS by revisiting certain features of the Hong Kong tax system (especially the territorial source principle) and consider how to make it more compatible with modern business environment and to align with the updated international tax rules and provide more certainty to taxpayers in Hong Kong.

Subsequent to the establishment of the Innovation and Technology Bureau in November 2015, the atmosphere for innovation and technology development in Hong Kong has been significantly enhanced. We welcome that the Government is committed to develop Hong Kong into a smart city and is injecting more resources in developing innovation and technology in Hong Kong. To further encourage businesses to invest in significant research and development activities apart from the support already provided, the Government should seriously consider granting a super tax deduction on qualifying research and development expenditure spent by companies engaging in high-technology business; and relaxing the condition for tax deduction of research and development expenditure.

Notwithstanding that the Financial Secretary states the Government has attached great importance to the development of SME and rendered them key assistances, apart from the one-off profits tax reduction applicable to all profits taxpayers, no specific tax measures, such as lower profits tax rate for companies with low gross income (say annual gross income less than HK$5 million), are proposed to help the SME, despite there have been continuous calls from various business associations and professional bodies.

As mentioned above, Hong Kong is facing a difficult economic climate due to both external and internal factors. The government expenditure is expected to keep growing at a faster pace than the revenue due to the ageing population and slowing economic growth. In addition, the fluid digital world means businesses operate and transact beyond traditional borders. As such, the Government should itself be innovative to come up with a tax system which could attract innovative businesses setting up in Hong Kong as well as to maintain a healthy and sustainable fiscal system. At the same time, the international competitiveness of Hong Kong tax regime has to be examined since other jurisdictions are adjusting their tax structures, reducing tax rates or offering tax concessions to enhance competitiveness. We are pleased that the Financial Secretary plans to set up a tax policy unit in the Financial Services and the Treasury Bureau to comprehensively examine the tax issues.

Consistent with prior years, we reiterate that the Government shall continue to review its revenue and expenditure in a timely manner in a way to allow the matching principle to be observed. We believe that the advance in technology should allow the Government to better account for its expenditure and applying the matching principle.

RSM Tax Advisory (Hong Kong) Limited

RSM Hong Kong's dedicated and experienced tax specialists can:

- Advise on tax efficient holding and operational structures for new cross-border investment, including the formation of Hong Kong and Chinese business entities
- Review existing cross-border investment structures, advise on identified deficiencies, quantify any potential exposure from such deficiencies, and further advise on restructuring approach and procedures
- Assist clients to discuss and clarify matters with tax officials, including transfer pricing and advance rulings
- Act as client representative in tax audits and tax investigations
- Provide transaction support services on mergers and acquisitions, including tax due diligence, deal structure advice, tax health checks, related human resources arrangements and other tax compliance and consultation services
- Advise on human resources and structuring employment arrangements in a tax-efficient manner
- Advise on tax equalization schemes
- Provide tax compliance services for individual and corporate clients in Hong Kong and China

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