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

HONG KONG BUDGET – 2018/19

The Financial Secretary, Mr. Paul Chan, delivered the 2018-19 Budget Speech at the Legislative Council on 28 February 2018.

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

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

1. Our Commentary

In the 2018-19 Budget, the Financial Secretary forecasts a consolidated budget surplus of HK$138 billion for 2017-18, which is over eight times the original estimated surplus of HK$16.3 billion. The enormously 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$1,092 billion by 31 March 2018.

Hong Kong is expected to face challenges such as increasing operating costs and shrinking profit margin in 2018 owing to the rising interest rate in the United States, the immense impact brought by innovation and technology and the increasing keen competition from surrounding jurisdictions.

Generally speaking, the Budget succeeds in addressing several key issues such as developing the economy, examining the land and housing supply, improving the people's livelihood and strengthening the manpower of Hong Kong. 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, in particular the financial services industry and trading and logistics industry, and diversifying the development in different industries in particular the innovation and technology and the creative industries.

Further, we welcome that the Government commits to seize opportunities from the national Belt and Road Initiative and Great Bay Area development. On the other hand, we appreciate that more expenditure will be spent on elderly services and health care in the coming future.

As tax practitioners, we are delighted that the Government recognized that taxation is an important aspect to help boosting economy and enhancing competitiveness of Hong Kong. In recent years, tax legislations have been amended for several issues such as introducing tax incentives for corporate treasury centres, extending the profits tax exemption available to offshore funds to private equity funds, and implementing tax concessions for the aircraft leasing business. Further, tax relief measures were announced by the Chief Executive in her maiden Policy Address about the two-tier profits tax rate regime to support Small and Medium Enterprises ("SMEs") which has already been introduced to the Legislative Council and the super tax deduction for Research and Development ("R&D") expenditure.

However, the all along advantages of low tax rates and relatively straight forward tax legislation of Hong Kong tax system are reducing. Tax rates, in particular corporate tax rate, have been reduced in various major jurisdictions. After the tax reforms passed in 2017, the corporate tax rate of the United States has been reduced significantly from 35% to 21%. The average corporate tax rates in Asian and European jurisdictions are 20% or lower. As such, the current profits tax rate of 16.5% is not as attractive as in prior years. Although the Budget reiterates that the Government will maintain a simple and competitive tax regime, the proposed lengthy tax legislation to comply with the minimum standards of Base Erosion and Profit Shifting (BEPS) action plans, in particular the codification of certain transfer pricing principles into the Inland Revenue Ordinance ("IRO") and implementation of the transfer pricing documentations including Country-by-Country Reporting, obviously added complexity to the Hong Kong simple tax regime.

To further increase Hong Kong's competitiveness and to grasp opportunities to boost the economy, the Government should consider to implement more tax related measures in coming future. We welcome the Budget reiterates that the Government is actively seeking to expand the network of Comprehensive Avoidance of Double Taxation Agreements ("CDTAs") with other jurisdictions including those along the Belt and Road to fortify Hong Kong's position as an international trade and investment hub. We are of the opinion that the Government should also put effort into entering CDTAs with other jurisdictions relevant and important to Hong Kong, such as Australia, the United States, Taiwan, etc. so that the Hong Kong taxpayers can truly enjoy the benefits provided by the CDTAs.

On the other hand, more tax measures should be proposed to grasp the opportunities of Great Bay Area development so as to diversify the economy and promote Hong Kong as the R&D centre as well as an Intellectual Property ("IP") hub. We certainly appreciate the already proposed super tax deduction on R&D expenditure. However, we are of the view that the eligibility of qualifying R&D expenditure should be relaxed so as to ensure a widen application of the tax incentive. Cash rebate for qualifying R&D expenditure and cash refund to tax loss incurred by taxpayers engaging in innovation and technology industry should be introduced to support the start-up companies. Further, the range of IP rights eligible for capital expenditure deductions should be expanded to encourage the creation and development of IP.

Financial industry has all along been one of the Hong Kong's pillar industries. We welcome that the Budget proposes to extend the scope of tax exemption from debt instruments with an original maturity of not less than seven years to instruments of any duration; and seeks to amend the IRO to extend the profits tax concession to the specified treasury services provided by qualifying corporate treasury centres to their onshore associated corporations. To strengthen Hong Kong's position as an international financial center, the offshore fund exemption should be further reviewed with a view to extend the scope to certain resident funds.

As repeatedly mentioned in recent years, to strengthen the role as a super connector between Mainland China and other Asian countries, tax incentives should be introduced for regional headquarters set up in Hong Kong to overcome the increasing competitive environment.

In addition, the fluid digital world means businesses operate and transact beyond traditional borders. As such, the Government should allocate more resources to come up with a tax system which could maintain a healthy and sustainable fiscal system. We are pleased that a tax policy unit has been set up in 2017 to comprehensively examine the tax issues. Further, special attention should be addressed to crypto currencies and Initial Coin Offering ("ICO") which are a reflection of the rapid development of digital economy. It is recommendable for the Government to come up with clear guidelines on the regulatory regime about dealing with crypto currencies and ICO activities in Hong Kong, including guidelines to the banking sector to facilitate ICO issuers and companies dealing with crypto currencies. Governments in some jurisdictions have been considering/introducing tax preferential treatments for ICO issuers. Hong Kong shall also take action immediately to evaluate the situation and decide what tax treatments should be applied for the crypto currencies and ICO if Hong Kong is to position itself as a leader in the digital economy.

Albeit the increment of the government expenditure in 2017 was lower than estimation, the government expenditure is expected to keep growing at a faster pace than the revenue due to the ageing population and slowing economic growth. 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.

2. Economic Performance and Outlook

- GDP grew by 3% in real terms and GDP per capita became HK$360,200 in 2017. GDP growth rate is forecasted to be 3-4% in 2018. GDP per capita is forecasted to be HK$376,900 – HK$380,500 in 2018.

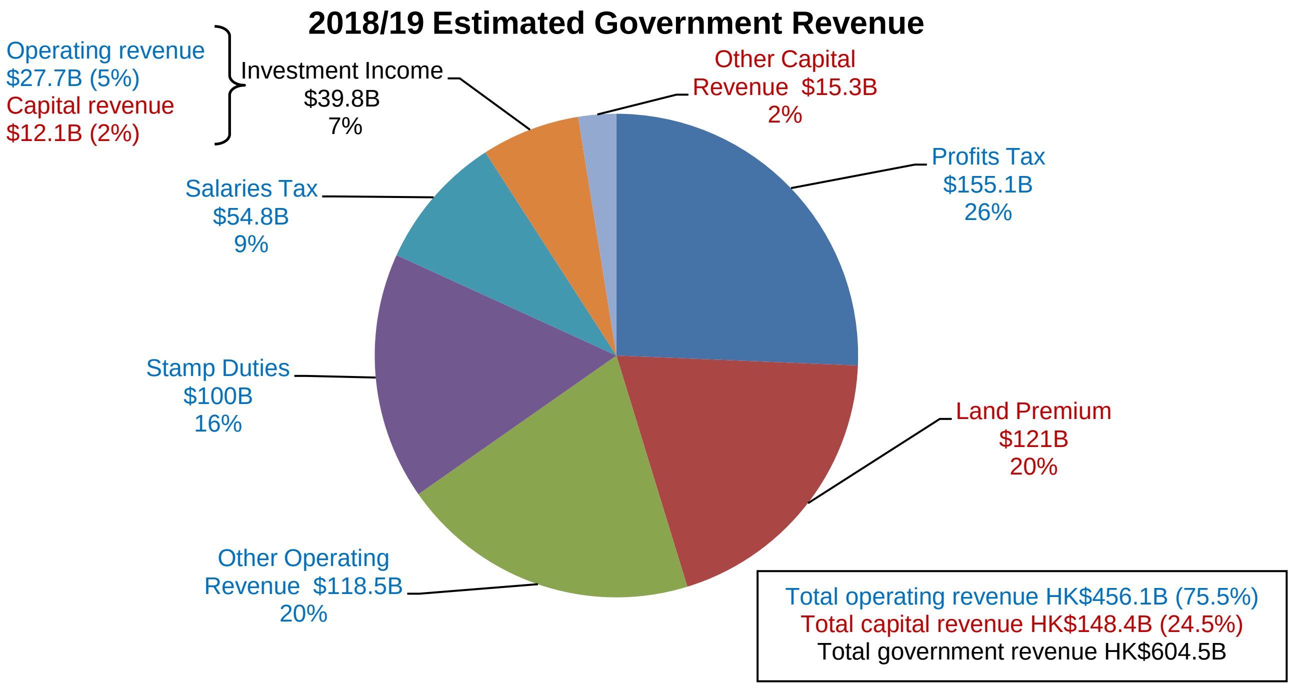
- The labour market further tightened with the unemployment rate dropped to 2.9% in 2017.

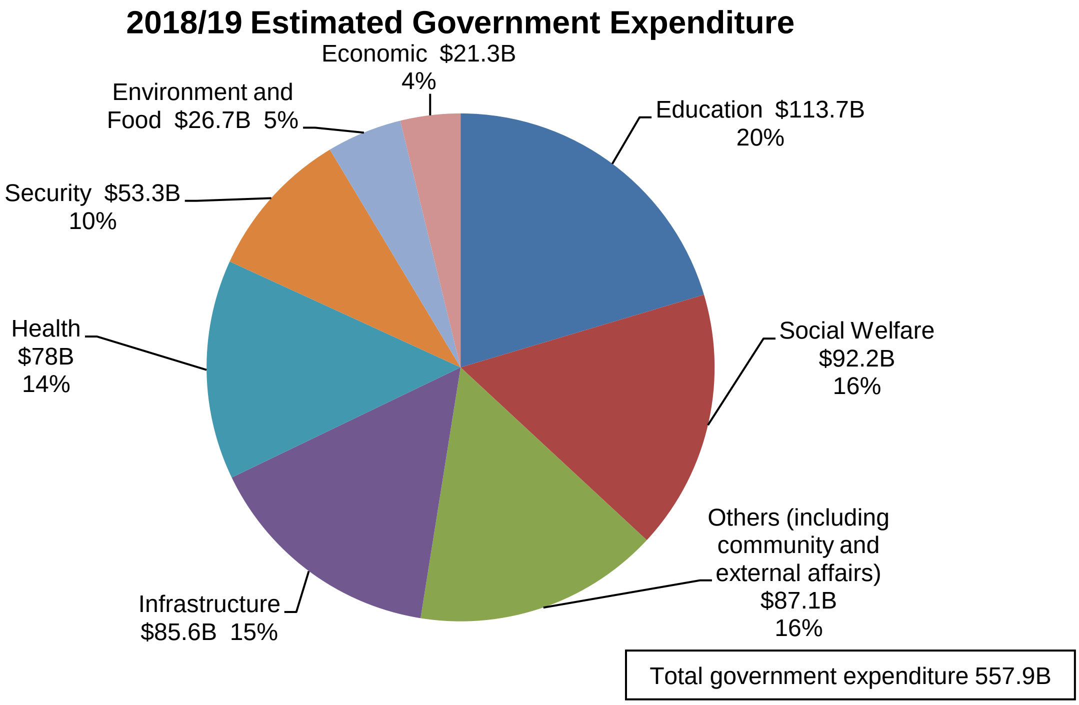
- The underlying average inflation rate was 1.7% in 2017. The underlying inflation rate is forecasted to be 2.5% in 2018.

3. Financial Highlights

- A surplus of HK$64 billion in the Operating Account and a surplus of HK$138 billion in the Consolidated Account are forecasted for the year ending 31 March 2018. By 31 March 2018, the Hong Kong's fiscal reserves will be increased to HK$1,092 billion.

- A surplus of HK$14.6 billion in the Operating Account and a surplus of HK$46.6 billion in the Consolidated Account are forecasted for the fiscal year 2018/19. By 31 March 2019, fiscal reserves are expected to reach HK$1,138.6 billion. Breakdowns of 2018/19 estimated total government revenue and total government expenditure are as follows:-





4. Relief and Measures

- ***Profits Tax***

Comparison Tables on Profits Tax Reduction

	2016/17	2017/18
One-off Reduction	Reduce 2016/17 tax by 75% ceiling @ HK$20,000	Reduce 2017/18 tax by 75% ceiling @ ***HK$30,000***

Comparison Tables on Profits Tax Rate

Tax Rate	2017/18	2018/19
Corporations	16.5%	16.5%
Unincorporated businesses	15%	15%

- ***Salaries Tax***

Comparison Tables on Salaries Tax Reduction

	2016/17	2017/18
One-off Reduction	Reduce 2016/17 tax by 75% ceiling @ HK$20,000	Reduce 2017/18 tax by 75% ceiling @ ***HK$30,000***

Comparison Tables on Salaries Tax Rate

Tax Rate	2017/18	Tax Rate	2018/19
2%	1st HK$45,000	2%	***1st HK$50,000***
7%	2nd HK$45,000	***6%***	***2nd HK$50,000***
12%	3rd HK$45,000	***10%***	***3rd HK$50,000***
17%	Balance	***14%***	***4th HK$50,000***
-	-	17%	Balance
The total tax payable is limited to 15% on net assessable income (before deduction of personal allowances).			

Comparison Tables on the Deductions on Salaries Tax

Deductions	2017/18	2018/19
Expenses of self-education	HK$100,000	HK$100,000
MPF Contribution	HK$18,000	HK$18,000
Home Loan Interest	HK$100,000; 20 Years	HK$100,000; 20 Years
Elderly Residential Care	HK$92,000	***HK$100,000***
Approved Charitable Donations	35% of income	35% of income

Comparison Tables on the Personal Allowances on Salaries Tax

Personal Allowances	2017/18	2018/19
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
Disabled	-	***HK$75,000***
Child (1st – 9th child)		
Year of Birth	HK$200,000 each	***HK$240,000 each***
Other Years	HK$100,000 each	***HK$120,000 each***
Dependent Parent/Grandparent 60+		
Residing Together	HK$92,000 each	***HK$100,000 each***
Not Residing Together	HK$46,000 each	***HK$50,000 each***
Dependent Parent/Grandparent 55-59		
Residing Together	HK$46,000 each	***HK$50,000 each***
Not Residing Together	HK$23,000 each	***HK$25,000 each***
Disable Dependent	HK$75,000 each	HK$75,000 each
Dependent Brother / Sister	HK$37,000 each	HK$37,500 each

- ***Rates***

  Waiving rates for four quarters of 2018-19, subject to a ceiling of $2,500 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 two months of the allowances.
  - Introducing a tax deduction for people who purchase eligible health insurance products for themselves or their dependants under the Voluntary Health Insurance Scheme. The annual tax ceiling of premium for tax deduction is $8,000 per insured person.
  - Paying the examination fees for candidates sitting for the 2019 HKDSE Examination.
  - Providing a one-off grant of HK$2,000 to each student in need.
  - Raising the subsidy ceiling of Continuing Education Fund from HK$10,000 to HK$20,000 per applicant.
  - Enterprises will enjoy a 300% tax deduction for the first $2 million qualifying research & development expenditure, and a 200% deduction for the remainder.
  - Allowing tax deduction to be claimed in full in one year, instead of the current time frame of five years, for capital expenditure incurred by enterprises in procuring eligible energy efficient building installations and renewable energy devices.
  - Extending the scope of tax exemption from debt instruments with an original maturity of not less than seven years to instruments of any duration under the Qualifying Debt Instrument Scheme.
  - Waiving in full the first registration tax for electric commercial vehicles, electric motor cycles and electric motor tricycles until 31 March 2021.

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

To improve people's livelihood and drive for society progress, the Government will implement measures in the following areas:-

➢ ***Promoting Innovation and Technology ("I&T")***

- Allocating HK$20 billion on the first phase of the Hong Kong-Shenzhen Innovation and Technology Park in the Lok Ma Chau Loop.
- Injecting HK$10 billion into the Innovation and Technology Fund ("ITF").
- Earmarking HK$10 billion to support the establishment of two research clusters on healthcare technologies and on artificial intelligence and robotics technologies.
- Allocating HK$10 billion to the Hong Kong Science and Technology Parks Corporation.
- Allocating HK$200 million to Cyberport to enhance the support for start-ups and promote the development of digital technology ecosystem.
- Allocating $100 million to Cyberport to promote the development of e-sports.
- Earmarking HK$500 million under the ITF to implement, in the second half of the year, the Technology Talent Scheme as announced in the Policy Address.

➢ ***Enhancing Financial Services***

- Setting aside a dedicated provision of HK$500 million for the development of the financial services industry in the coming five years.
- Making plans to set up an academy of finance by the Hong Kong Monetary Authority.
- Launching new regime of listing in the second quarter of this year after consultation conducted by the Stock Exchange of Hong Kong.
- Launching a three-year Pilot Bond Grant Scheme to attract local, Mainland and overseas enterprises to issue bonds in Hong Kong.
- Amending the qualifying debt instrument scheme by increasing the types of qualified instruments.
- Extending the scope of tax exemption from debt instruments with an original maturity of not less than seven years to instruments of any duration.
- Continuing to issue Silver Bonds in 2018 and 2019.
- Launching a green bond issuance programme with a borrowing ceiling of $100 billion.
- Introducing a Green Bond Grant Scheme to subsidise qualified green bond issuers in using the Green Finance Certification Scheme.
- Reviewing the existing tax concession arrangements applicable to the fund industry with regard to international requirements on tax co-operation.
- Extending the coverage of profits tax concession to specified treasury services provided by qualifying corporate treasury centres to all their onshore associated corporations.
- Exploring the possibility of including a wider range of investment products in the two-way mutual access mechanism.
- Launching a Faster Payment System to provide real-time, round-the-clock, cross-institution payment and fund transfer service.
- Launching a Life Annuity Scheme in the middle of this year. Purchasers will only have to pay a lump sum in exchange for a stable flow of monthly income.

- ***Enhancing Trading and Logistics***

  - Seeking to sign Free Trade Agreements, Investment Promotion and Protection Agreements and Comprehensive Avoidance of Double Taxation Agreements ("CDTAs") with other economies, including those along the Belt and Road, to fortify Hong Kong's position as an international trade and investment hub.
  - Considering the redevelopment of the Air Mail Centre at the Hong Kong International Airport and setting aside HK$5 billion for the project.
  - Capping the charge for each trade declaration at HK$200 to encourage the trading and logistics industry to move up the value chain.

- ***Supporting Small and Medium Enterprises ("SMEs") and Tourism***

  - Allocating an additional HK$396 million to the tourism industry in the new financial year, of which HK$226 million being provided for the Hong Kong Tourism Board to implement the Development Blueprint for Hong Kong's Tourism Industry released by the Tourism Commission.
  - Allocating HK$30 million for enhancing the Pilot Information Technology Development Matching Fund Scheme for Travel Agents.
  - Allocating a total of HK$310 million in the next few years to support the Ocean Park in developing education and tourism projects.
  - Injecting HK$1.5 billion into the Dedicated Fund on Branding, Upgrading and Domestic Sales ("BUD Fund").
  - Injecting HK$1 billion into the SME Export Marketing and Development Funds.
  - Extending the geographical scope of the Enterprise Support Programme under the BUD Fund from the Mainland to include the ASEAN countries.
  - Increasing the cumulative funding ceiling for enterprises under the SME Export Marketing Fund from HK$200,000 to HK$400,000, and removing the existing condition on the use of the last HK$50,000 of grants.
  - Extending the application period for the special concessionary measures under the SME Financing Guarantee Scheme to 28 February 2019.
  - In the five financial years from 2018-19, providing a total of HK$250 million additional funding to the Hong Kong Trade Development Council for assisting local enterprises (SMEs in particular) in seizing opportunities arising from the Belt and Road Initiative and the Bay Area development.

- ***Supporting Other Industries***

  - Setting up a HK$1 billion Construction Innovation and Technology Fund to support the industry to harness innovative technology.
  - Injecting a total of HK$1 billion into the CreateSmart Initiative to support development of the creative industries.

- ***Optimising Land Utilisation and Increasing Land Supply***

  - Estimated production of public housing will be about 100,000 units for the next five years.
  - Estimated supply of private housing flats will be about 20,800 residential units annually in the next five years.
  - Potential land supply for private housing in 2018-19 is expected to have a capacity to produce about 25,500 units.
  - Providing 4 commercial/hotel sites, capable of providing about 530,000 square metres of floor area.

- Setting aside HK$1 billion to subsidise eligible projects, to optimize the use of vacant government sites or school premises.
- Pursuing the “single site, multiple use” model in multi-storey developments on “Government, Institution or Community” sites.

➢ ***Improving the Quality of Manpower***

- Injecting an additional HK$8.5 billion into the Continuing Education Fund (“CEF”) in 2018-19.
- Raising the subsidy ceiling of the CEF from HK$10,000 to HK$20,000 per applicant and extending the coverage of the CEF.
- Setting up the Youth Development Commission in the first half of this year and setting aside HK$1 billion to support the work of the Commission.

➢ ***Improving Livelihood of People***

- Setting aside a sum of HK$300 billion as an initial provision to support the second 10-year hospital development plan.
- Allocating additional recurrent funding of nearly HK$6 billion to the Hospital Authority in 2018-19.
- Allocating additional HK$200 million each year to enhance the healthcare professional training provided by the Hospital Authority.
- Raising the accumulation limit of Elderly Health Care Vouchers from HK$4,000 to HK$5,000 in 2018 to allow greater flexibility to users.
- Providing an additional HK$1,000 worth of vouchers to eligible elderly persons in 2018-19 on a one-off basis.
- Proposing to provide a tax deduction for people who purchase eligible health insurance products for themselves or their dependents under the Voluntary Health Insurance Scheme with the annual tax ceiling of premium for tax deduction of HK$8,000 per insured person.
- Making an additional annual funding of $48 million to enhance the special employment programmes of the Labour Department so as to encourage employers to hire job seekers with special employment needs.

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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