



Hong Kong Budget Summary 2018-2019



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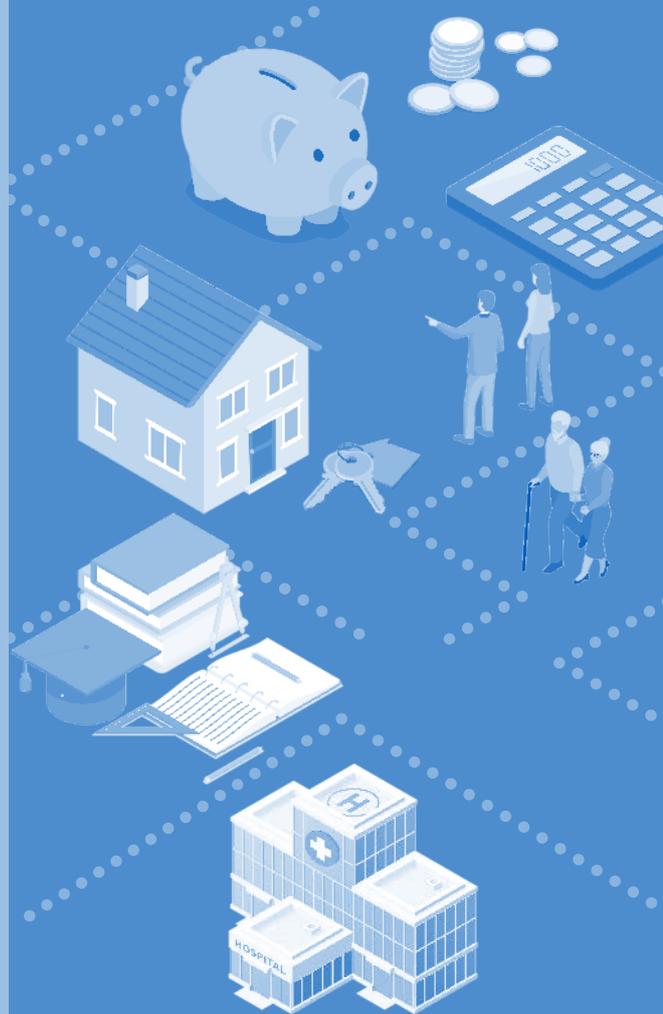


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Legislative proposals do not generally become law until their enactment and may be modified by the Legislative Council before enactment.

It should be noted that the following information is presented in summary form and readers are advised to seek professional advice before formulating business decisions.



Budget commentary 2018-2019

In a typical Hong Kong Budget speech, the Financial Secretary announces a big surplus, proposes a few new spending projects, then adds the surplus to reserves. Today's Budget speech was no exception. Having another year of healthy fiscal surplus gave the Financial Secretary, Paul MP Chan, additional room to spend a bit more than usual on 'giveaways'.

The three main stated objectives of the Budget were:

- **Diversified economy:** To better support and provide a broader range of industries for the future development of Hong Kong
- **Investing in the future:** To address the needs of the ageing population and ensure that Hong Kong's living environment is improved environmentally and technologically, making it an ideal location in which to live and work
- **Caring and sharing:** To better support children and young people with care, protection and opportunities; relieve the financial burden of middle-class families; and support the underprivileged and vulnerable in Hong Kong

Looking at the numbers, the Financial Secretary's estimate of Hong Kong's fiscal surplus for 2017-18 of HKD 16.3 billion in last year's budget was significantly lower than the current estimated fiscal surplus of HKD 138 billion. The primary drivers of the government's higher than expected fiscal surplus are the unexpected increases in revenue from land sales and Stamp Duty.

Hong Kong's fiscal reserves are expected to reach HKD 1,092 billion by 31 March 2018 and represent almost two years of government expenditure. This is some 'rainy day' that Hong Kong is saving for!

Pointing out Hong Kong's conservative fiscal prudence is by no means a criticism. The approach of maintaining a perennial fiscal surplus has served Hong Kong well in the past and is the envy of many developed economies globally. With the new Chief Executive, Carrie Lam Cheng Yuet-ngor, and the new Financial Secretary, we were interested to see if things would change much this time around, but it turned out to be more of the same. The theory seems to be – "if it ain't broke, don't fix it". Many people will like that.

There had been calls for the government to plough back more money for social development projects. Those people might be disappointed, but perhaps placated by the increased spending, especially on health, education, elderly and disabled care, sports, culture, and community. The disadvantaged and vulnerable members of Hong Kong society are also receiving needed attention from the government.

The real winner is the innovation and technology (I&T) industry. The government is clearly keen to develop this as a pillar industry. Significantly, the government has specifically targeted four aspects of I&T as likely winners, namely biotechnology, artificial intelligence (AI), smart city development and financial technologies (fintech).

For business generally, there was not much to get excited about, as no significant tax incentives or reductions were announced.

The Financial Secretary did highlight in his speech that support would be given to strengthening Hong Kong's pillar industries. However, while some of the Budget measures discussed were new, they were by no means unexpected or radical.



For the financial services sector, there was some tinkering and enhancement. The highlights include measures to support the Hong Kong bond market, as well as the insurance and asset management sectors. While the details are limited, it is nevertheless welcome.

Financial support and investment was also pledged for the pillar industries of tourism and transportation & logistics, as well as the construction, professional services and creative industries.

Increased access to funding, and assistance for small and medium-sized enterprises (SMEs) was also discussed. Noteworthy support was the pledging of financial assistance to SMEs to enable them to seize opportunities from the 'Belt & Road' and Greater Bay Area initiatives.

To address the issue of employment shortages, the Financial Secretary suggested that labour could be imported. This would no doubt be welcomed by the business sector, but one wonders whether this is viable given the high costs of housing and living in Hong Kong.

For the ordinary person on the street, there were the usual tax band adjustments and rebates, but this is nothing new.

Interestingly, parts of the Budget rewarded and encouraged sustainability. These initiatives include green bonds to support the government's green public works, enhanced tax deductions for energy efficient buildings, the promotion of public transport, and concessions for electric vehicles. For electric cars, new concessions apply where the buyer scraps an existing non-electric car; this is likely to be more effective from an environmental perspective than just a pure exemption as before. Overall, it is difficult to tell whether the new green measures will confer any real environmental benefit.

Finally, the Financial Secretary disclosed that Hong Kong will be departing from the benchmark whereby government expenditure was traditionally linked to 20% of gross domestic product (GDP), rising in the coming year to 21%. This perhaps reflects what he described as the Chief Executive's "new fiscal philosophy" of focusing on new financial management principles to optimise the use of the surplus for Hong Kong and relieving people's burdens. As the government copes with these new demands, it needs to be resourced accordingly.

Overall, this was a 'safe' Budget. Although it may represent 'more of the same', it gives a big win to the I&T sector. The Budget is difficult to object to. It is directionally safe. Some people would have wanted higher expenditure on social and community initiatives, and it is they who might be disappointed. The Budget did not tangibly address some core issues the population faces such as housing affordability and pollution (despite the green initiatives above). The Financial Secretary did mention that financial resources alone would not solve Hong Kong's housing problem and that the Task Force on Land Supply was considering matters in further detail; his solution for now appears to be that increasing land supply and the coming increases in interest rates will help dampen real estate prices over time.

The projections for the future indicate that the government's fiscal policy of conservative prudence is unlikely to change in the coming years.

KPMG survey results vs Budget proposals

KPMG China recently conducted a survey of over 300 senior business executives about their business concerns in Hong Kong and their expectations regarding the 2018-2019 Hong Kong Budget. Our key survey findings are highlighted below:

Top priority for the 2018-2019 Hong Kong Budget

- Almost half of the respondents consider strengthening Hong Kong's position as an international business centre as the top priority for the 2018-2019 Hong Kong Budget.
- Other respondents suggest capturing the 'Belt and Road' and Greater Bay Area opportunities, and focusing on youth support.



Enhancing the competitiveness of Hong Kong's tax system

- According to the respondents, the most effective measure to enhance competitiveness is introducing a tax incentive for regional headquarters.
- Other views include introducing group tax loss relief and expanding the scope of tax exemption for funds.



Measures/new tax incentives targeting the middle class in Hong Kong

- The majority of respondents suggest that the existing Salaries Tax bands and/or tax rates for individuals should be adjusted.
- Other respondents prefer allowing a tax deduction for medical insurance premiums paid and introducing a working mother allowance.



Tax measures to promote R&D activities in Hong Kong

- Results show that respondents equally support all three of the proposed measures for promoting research & development (R&D) activities in Hong Kong (i.e. 'expand the scope of "approved research institutions" for R&D tax deduction purposes', 'allow tax losses incurred from R&D activities to be cashed out instead of being carried forward' and 'expand the scope of deductible intellectual property-related capital expenditure').





Below we summarise how the 2018-19 Budget proposes to address some of the concerns identified in the KPMG survey:

Increase competitiveness and capture business opportunities

- Extend the scope of the Profits Tax exemption on debt securities to attract corporate bond issuance
- Set aside HKD 500 million for the development of the financial services industry
- Expand the government's network of Economic and Trade Offices, including setting up an office in Thailand, to enhance trade relations with ASEAN countries and support the 'Belt & Road' Initiative
- Expand trade, investment and tax treaty networks to open up new markets



Promote R&D activities in Hong Kong

- Set aside HKD 20 billion for developing the Hong Kong-Shenzhen Innovation and Technology Park
- Inject HKD 10 billion in the I&T Fund supporting applied R&D
- Allocate HKD 20 billion for establishing research clusters on healthcare technologies, and AI and robotics technologies, as well as for upgrading facilities at the Science Park



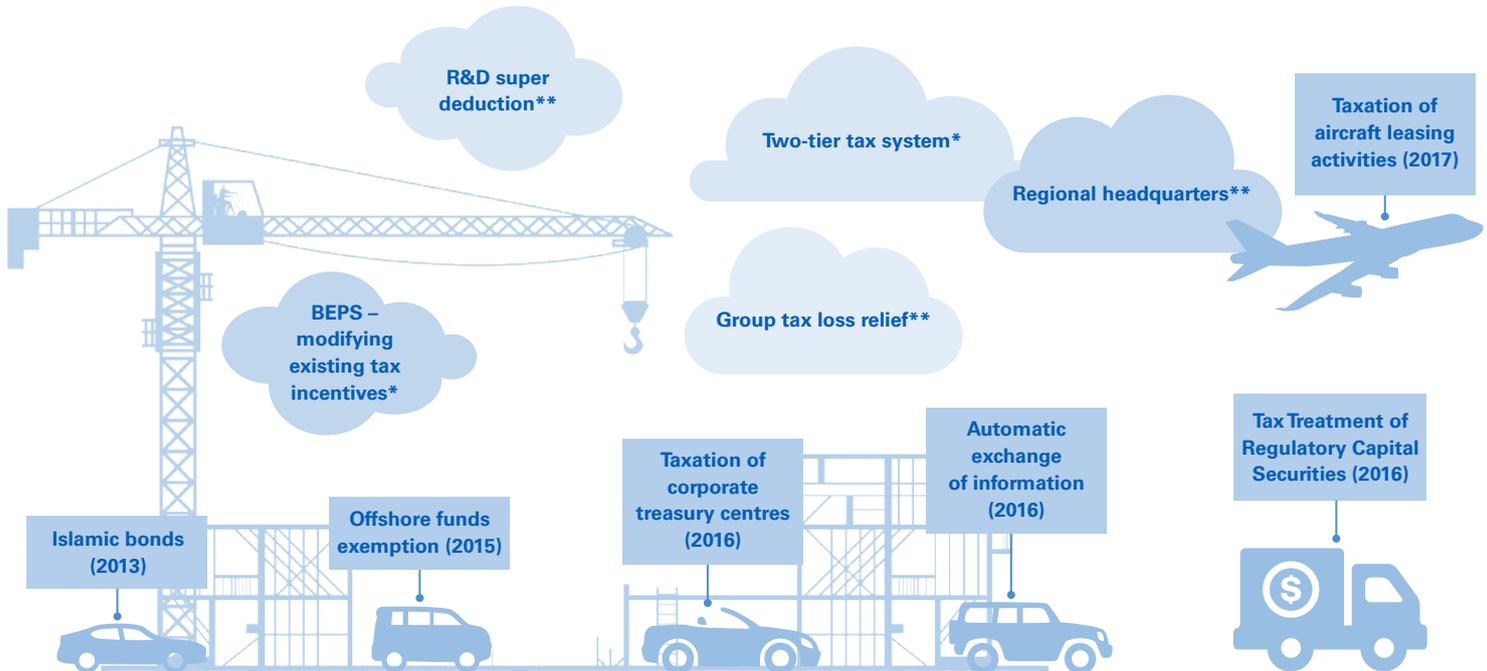
Tax measures for individuals

- Reduce Salaries Tax and tax under personal assessment by 75%, capped at HKD 30,000
- Widen the Salaries Tax rate bands from HKD 45,000 to HKD 50,000
- Increase the number of tax bands from four to five, and adjust the marginal tax rates to 2%, 6%, 10%, 14% and 17% respectively
- Increase the basic and additional allowances for children and dependent parents or grandparents
- Increase the tax deduction ceiling for elderly residential care expenses
- Introduce a tax deduction for Voluntary Health Insurance Scheme premiums, subject to a ceiling of HKD 8,000
- Propose tax deductions for purchasing deferred annuity products and MPF voluntary contributions



Maintaining a competitive tax system

In her maiden Policy Address on 11 October 2017, Hong Kong's Chief Executive, Carrie Lam, stressed the importance of taxation policies to further enhance Hong Kong's competitiveness. As such, we expect the government to introduce more policy initiatives and programmes, some of which are illustrated below, to maintain Hong Kong's position as Asia's leading international business centre.



* Pending legislation
** Proposal

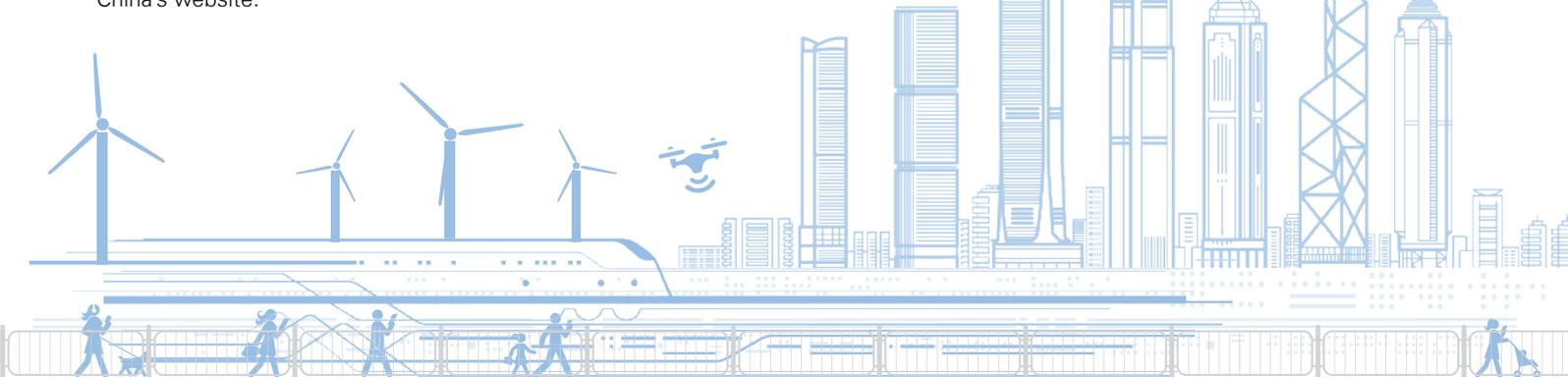


One of the proposed tax initiatives is the introduction of a regional headquarters (RHQ) tax regime in Hong Kong. KPMG China believes that the RHQ tax incentive would greatly enhance Hong Kong's competitiveness as an RHQ location in the Asia Pacific region. RHQs can bring increased foreign investment, prestige, demand for local goods and services, and local employment. It would also complement the corporate treasury centre (CTC) tax incentive recently introduced in Hong Kong. The implementation of the RHQ tax incentive will ensure that Hong Kong maintains its competitive position as a leading regional business and financial hub.

To incentivise RHQ establishment in Hong Kong, KPMG China proposes the following core features:

- Provide a 50% Profits Tax rate reduction (8.25%) for all qualifying RHQ profits, in line with the CTC regime
- Earn arm's length profits from performing regional management and coordination services to related group companies
- Undertake a certain level of expenditure and investment into Hong Kong with respect to the RHQ activities
- Employ suitably qualified local professionals to perform the RHQ's core functions.

Further details can be found in KPMG China's publication, *The case for a Hong Kong RHQ tax incentive*, which can be accessed on KPMG China's website.



Budget summary



Reduction of 75% in Profits Tax payable for 2017-18, subject to a ceiling of HKD 30,000



Profits Tax

Persons conducting business in Hong Kong are liable to Profits Tax on profits arising in or derived from Hong Kong.

The Financial Secretary did not change the Profits Tax rates and allowances for 2018-19. As in previous years, a 'one-off' reduction of 75% of the Profits Tax payable for 2017-18 has been proposed, with an increased ceiling of HKD 30,000. The reduction will be reflected in taxpayers' final tax payable for 2017-18.

Subject to the enactment of a two-tiered Profits Tax rate regime, the Profits Tax rate for corporations will remain at 16.5% for 2018-19, and for unincorporated businesses, it will remain at 15%. This proposed regime will reduce the current rate by 50% for the first HKD 2 million of assessable profits, where applicable.

The rate of deeming assessable profits from royalty type payments for the use of intellectual property will remain at 30% or 100% of the payment, as the case may be. Therefore, the effective tax rate on such payments will remain at 4.95% or 16.5% for 2018-19.

Capital allowances

The Depreciation Allowance rates for plant and machinery remain unchanged at:

- Initial Allowance: 60% of qualifying expenditure in the year the expenditure is incurred
- Annual Allowance: 10%, 20% or 30% on the written down value brought forward, depending on the category to which the asset belongs

Industrial Building Allowances also remain unchanged at:

- Initial Allowance: 20% of qualifying expenditure
- Annual Allowance: 4% of qualifying expenditure

The Commercial Building Allowance on qualifying expenditure remains at 4% per annum.

A full deduction is available for certain capital expenditure, such as expenditure on computer hardware and software, as well as for certain other types of expenditure, which would otherwise be treated as capital in nature and non-deductible.

The 100% Profits Tax deduction has been retained for capital expenditure on environmentally friendly machinery and equipment in the first year of purchase and for capital expenditure incurred on environmentally friendly vehicles in the year of purchase.

The government proposes reducing the period over which deductions may be claimed on energy efficient building installations to one year.



A number of proposals were announced, including enhanced R&D deductions and the extension of various incentives

Deductions for donations

The ceiling for tax-deductible charitable donations remains at 35% of assessable profits for 2018-19.

Key policy initiatives

The Financial Secretary announced the following proposals:

- Extend tax concession for qualifying debt instruments to include those listed on the Stock Exchange of Hong Kong and with maturity periods of any duration
- Extend tax concession to specified treasury services provided by qualifying CTCs to their onshore associated corporations
- Commence operation of the regime for open-ended fund companies and related tax exemption later this year
- Examine the feasibility of introducing a limited partnership regime for private equity funds
- Continue to participate in the negotiation of more Comprehensive Double Taxation Agreements (CDTAs)
- Introduce enhanced deductions for I&T expenditure, which includes a 300% tax deduction for the first HKD 2 million of qualifying R&D expenditure and a 200% deduction for the remainder.



Salaries Tax

The Financial Secretary proposed a number of measures aimed at reducing the tax burden on individuals. With respect to Salaries Tax – which is charged on income arising in or derived from Hong Kong from an office or employment, or a pension – these measures include a one-off reduction, increases in several personal allowances, and the widening and adjusting of the progressive rate bands. The Financial Secretary also provided details of the deduction for medical insurance contributions mentioned in last year's Budget.

A one-off reduction of 75% of Salaries Tax (and tax under personal assessment) for 2017-18 was proposed, subject to a ceiling of HKD 30,000. The reduction will be reflected in the final tax payable for 2017-18.

The tax charge for 2017-18 and 2018-19 is the lower of the:

- Net assessable income less charitable donations and allowable deductions at the standard rate; or
- Net assessable income less charitable donations, allowable deductions and personal allowances, charged at the progressive rates.

2017-18	Rate	HKD	2018-19	Rate	HKD
First HKD 45,000	2%	900	First HKD 50,000	2%	1,000
Next HKD 45,000	7%	3,150	Next HKD 50,000	6%	3,000
Next HKD 45,000	12%	5,400	Next HKD 50,000	10%	5,000
Balance	17%		Next HKD 50,000	14%	7,000
			Balance	17%	



New personal disability allowance for eligible taxpayers – and increased allowances for children and maintaining dependent parents/ grandparents

The standard rate of Salaries Tax for 2017-18 and 2018-19 is 15%.

The Financial Secretary has proposed increases to the child allowances and to the dependent parent/grandparent allowances. He has also proposed introducing a personal disability allowance for eligible taxpayers.

The personal allowances for 2017-18 and 2018-19 are set out below:

		2017-18 HKD	2018-19 HKD
Personal allowances	Basic	132,000	132,000
	Married	264,000	264,000
	Single parent	132,000	132,000
	Disabled	-	75,000
Child allowances	1st to 9th child (each)		
	- Year of birth	200,000	240,000
	- Other years	100,000	120,000
Dependent parent allowances	Aged 60 or above	46,000	50,000
	Aged between 55 and 59	23,000	25,000
Dependent grandparent allowances	Aged 60 or above	46,000	50,000
	Aged between 55 and 59	23,000	25,000
Additional dependent parent and grandparent allowances	Aged 60 or above	46,000	50,000
	Aged between 55 and 59	23,000	25,000
Disabled dependant (spouse/child/parent/grandparent/brother/sister) allowances		75,000	75,000
Dependent brother/sister allowances		37,500	37,500

Applying the above Salaries Tax rates and allowances, a family of four will have to earn more than HKD 5,184,000 in 2018-19 before paying tax at the standard rate.

Tax deductions

The following items are deductible in determining a person's Salaries Tax liability:



A deduction is available for self-education expenses, in particular, fees for training courses run by approved institutions. The maximum amount of deductible expenses that can be claimed for 2018-19 is HKD 100,000.



Home mortgage interest payments are deductible against income subject to Salaries Tax. Owner occupiers may claim a deduction for mortgage interest payments up to a maximum of HKD 100,000 per year for one property. The deduction can be claimed for 20 years of assessment.



As an alternative to the personal allowance for maintaining a dependent parent/grandparent, a deduction is available for the expenses incurred in maintaining a dependent parent/grandparent in residential care. The Financial Secretary has proposed increasing the maximum deduction to HKD 100,000.



A deduction up to the maximum of the mandatory annual contributions payable under the Mandatory Provident Fund (MPF) scheme is available for contributions made by employees to recognised retirement schemes and MPF schemes. The maximum amount of deductible contributions for the year of assessment 2018-19 is HKD 18,000.



The Financial Secretary indicated that the tax deduction proposed in last year's Budget for eligible health insurance products will be capped at HKD 8,000 per insured person. Further details of the Voluntary Health Insurance Scheme are to be provided shortly.



A deduction of up to a maximum of 35% of assessable income is available for approved charitable donations.



Rates waiver
for all four
quarters of
2018-19, subject
to a ceiling of
HKD 2,500
per quarter for
each rateable
property



Property Tax

The standard rate remains at 15% for 2018-19.

Property Tax is payable in addition to rates, and is charged to the owner of any land or buildings situated in Hong Kong at the standard rate on the 'net assessable value' of such land or buildings. Generally, 'net assessable value' is calculated as the amount of rent receivable by the owner of the subject land or buildings (net of any rates which are paid by the owner), less a statutory 20% allowance for repairs and outgoings.

There are several exemptions, notably for corporations conducting business in Hong Kong.



Rates

Rates on properties throughout the territory remain at 5% of the rateable value. However, rates for all four quarters will be waived in 2018-19, subject to a ceiling of HKD 2,500 per quarter for each rateable property.



Stamp Duty

Property transactions

No changes were proposed to the Stamp Duty rates and banding on property transactions in the Budget. The banding for 2018-19 is set out as follows:



No changes were proposed to the Stamp Duty rates and banding on property transactions

Property consideration

HKD	HKD	Rate
Exceeds	Does not exceed	
	2,000,000	1.5%
2,000,000	2,176,470	HKD 30,000 + 20% of excess over HKD 2,000,000
2,176,470	3,000,000	3.0%
3,000,000	3,290,330	HKD 90,000 + 20% of excess over HKD 3,000,000
3,290,330	4,000,000	4.5%
4,000,000	4,428,580	HKD 180,000 + 20% excess over HKD 4,000,000
4,428,580	6,000,000	6.0%
6,000,000	6,720,000	HKD 360,000 + 20% of excess over HKD 6,000,000
6,720,000	20,000,000	7.5%
20,000,000	21,739,130	HKD 1,500,000 + 20% of excess over HKD 20,000,000
21,739,130		8.5%

A flat rate of 15% applies to residential property purchases, except for Hong Kong permanent residents on the purchase of their only residential property (which is subject to a reduced rate, generally at 50% of the above amounts).



Proposed measures to maintain Hong Kong's key status as the most competitive financial centre in Asia

In addition, Special Stamp Duty (SSD) is imposed on the sales price or market value of residential property as at the date of sale (whichever is higher). The SSD is to be imposed at the following penal rates, depending on when the property is bought and sold:

Property holding period

6 months or less	20%
More than 6 months but not exceeding 12 months	15%
More than 12 months but not exceeding 36 months	10%

The SSD is effective for residential properties resold within 36 months after acquisition, and is in addition to the *ad valorem* rates of Stamp Duty already imposed (up to 15%). Both the seller and buyer are jointly and severally liable for paying the SSD.

A further Buyer's Stamp Duty of 15% is payable on purchases of residential property by anybody who is not a Hong Kong permanent resident.

Sale and purchase of Hong Kong stock

No changes were announced to the rate of Stamp Duty payable in respect of transfers of Hong Kong stock. This remains at an aggregate *ad valorem* rate of 0.2% of the actual consideration or the value of the stock as at the transfer date, whichever is higher.

The trading of all exchange-traded funds remains exempt from Stamp Duty.

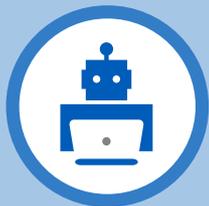


Other points of interest

Relief measures

Similar to last year, the Financial Secretary announced several one-off relief measures including:

- Providing an extra two months' allowance to recipients of Comprehensive Social Security Assistance (CSSA) payments, Old Age Allowance, Old Age Living Allowance and Disability Allowance. Similar arrangements will apply to the Low-income Working Family Allowance and Work Incentive Transport Subsidy.



Various measures proposed to boost I&T investments and enhance the commercialisation of I&T

Support for the financial services industry

For Hong Kong to remain the most competitive financial centre in Asia, the Financial Secretary introduced various measures including:

- Setting aside a dedicated provision of HKD 500 million to develop the financial services industry
- Launching a Pilot Bond Grant Scheme to attract local, mainland and overseas enterprises to issue bonds in Hong Kong; and continuing to issue Silver Bonds in 2018 and 2019
- Launching a green bond issuance programme for government's green public works projects to promote green finance
- Launching a Faster Payment System to provide real-time, round-the-clock, cross-institution payment and fund transfer services
- Examining the feasibility of introducing a limited partnership regime for private equity funds and related tax arrangements
- Exploring ways to enhance Hong Kong's competitiveness as an insurance hub, including reviewing tax arrangements and other regulatory requirements.

Nurturing innovation

The Financial Secretary also proposed various measures for boosting I&T investments and enhancing I&T commercialisation, including:

- Focusing on four areas: biotechnology, AI, smart city development and fintech
- Setting aside HKD 20 billion for the first phase of the Hong Kong-Shenzhen Innovation and Technology Park in the Lok Ma Chau Loop
- Injecting HKD 10 billion into the I&T Fund to support applied R&D
- Earmarking HKD 10 billion for the establishment of two research clusters on healthcare technologies and on AI and robotics technologies, to attract top scientific research institutions and technology enterprises
- Allocating HKD 10 billion to upgrade the facilities of the Science Park and enhance support for enterprises in the park
- Allocating HKD 200 million to Cyberport to enhance support for start-ups, and another HKD 100 million to develop e-sports.



Government enhances incentives to promote wider use of electric vehicles to improve roadside air quality

First Registration Tax for electric vehicles

With the aim of improving roadside air quality, the government has various measures to actively promote the wider use of electric vehicles and replace diesel and petrol vehicles, including:

- Continuing full exemption of First Registration Tax (FRT) for electric commercial vehicles, motorcycles and motor tricycles
- Continuing FRT waiver of up to HKD 97,500 for electric private cars
- Launching a 'one-for-one replacement' scheme to allow eligible private car owners to enjoy a higher FRT concession of up to HKD 250,000 if they buy a new electric private car and scrap their eligible private car.

All above concessions will remain in force until 31 March 2021.

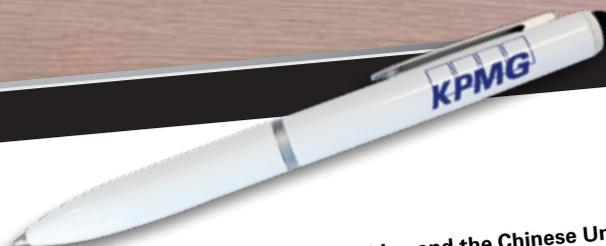
Source: 'The 2018-19 Budget'; Speech by the Financial Secretary, the Hon Paul MP Chan moving the Second Reading of the Appropriation Bill 2018; Wednesday, 28 February 2018

Comprehensive Double Taxation Agreements concluded by Hong Kong



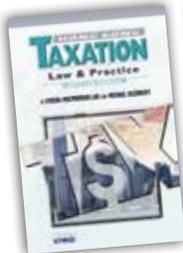
Source: Inland Revenue Department's website as at 16 January 2018

(In alphabetical order)



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