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Hong Kong Tax

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2016/17 Budget Analysis

Commitment to long-term growth, but lack of exciting relief measures

The Financial Secretary for the Hong Kong Special Administrative Region (HKSAR), Mr. John Tsang Chun-wah, delivered the 2016/17 Budget on 24 February 2016.

The Budget was prepared based on a better-than-expected surplus of HKD30 billion for 2015/16, mainly due to an increase in Stamp Duty, Profits Tax and Salaries Tax revenue. Tax reliefs, similar to prior years, are offered to individuals to ease the pressure on the middle class and to address the elderly and poverty.

Against the backdrop of the gloomy global business outlook and the deteriorating business environment facing the Hong Kong economy, the Budget emphasizes the need to foster talent development, explore new market opportunities for existing industries and encourage start-up and technological innovation, etc., which are deemed essential for Hong Kong's long-term economic development. Despite the surplus, the Budget contains fewer-than-expected measures for businesses.

This analysis highlights the key proposals in the 2016/17 Budget that affect businesses and individuals.

Businesses

No change has been proposed to the Profits Tax rate for 2016/17 (16.5% generally and 15% for incorporated businesses). As in previous years' Budgets, a one-time tax rebate of 75% of Profits Tax payable for 2015/16 has been proposed, up to a ceiling of HKD20,000. We welcome this relief measure, which will benefit businesses in general.

The Budget contains long-term directions and immediate measures for various industries to develop Hong Kong's advantages and gear up for an economic downturn. Immediate reliefs include waivers of the business registration fee and license fees for the tourism and catering industries. It is also announced in the Budget that the government will examine the use of tax concessions to encourage the aircraft leasing business. We welcome these measures that aim to boost the economy and specific industries.

Asset management and corporate treasury centers

The Financial Secretary mentioned several measures implemented in prior years, such as the Stamp Duty exemption for all exchange-traded funds and the extension of the offshore fund exemption to private equity funds, and the effectiveness of the measures. The Financial Secretary also provided an update on the progress of the legal framework for two initiatives: tax incentives for corporate treasury centers (CTCs) and open-ended funds (OEFs). The bills for these initiatives were introduced to the Legislative Council in December 2015 and January 2016, respectively. The CTC initiative will help attract multinational and Mainland enterprises to set up CTCs in Hong Kong, while the OEF initiative will further diversify the fund domiciliation platform in Hong Kong. We are pleased to see progress on the initiatives and recommend that the government and the Legislative Council expedite the passing of the legislation with a view to increasing the competitiveness of Hong Kong as an international treasury hub.

Innovation and technology

With the establishment of the Innovation and Technology Bureau in November 2015, the government announced policies to support innovation and technological advancement in Hong Kong and promote Hong Kong as a regional premier intellectual property (IP) hub. In addition to the HKD2 billion co-invest matching fund to encourage local technology start-ups and the HKD500 million project funding innovative products as announced in the Policy Address, the Financial Secretary mentioned in the Budget certain financial incentives designed to encourage the development, registration and trading of IP in Hong Kong. Resources are budgeted to encourage different sectors to apply innovation and technology to improve the quality of living, e.g. robotics in smart manufacturing process, intelligent home care equipment, etc. Focus also has been placed on the development and implementation of financial technology (FinTech) in a wide range of areas, such as electronic payments, big data analytics and crowdfunding to improve operation effectiveness in financial industries.

The only tax measure related to innovation and technology announced in the Budget is the expansion of the tax deduction for capital expenditure for the purchase of IP rights to cover three new categories: layout-design of integrated circuits, plant varieties and rights in performance. The exact nature of the IP rights covered and the implementation details are not entirely clear.

We appreciate the government's efforts to support innovation and technology, but believe that more favourable tax measures could be introduced to encourage the development of such industries in Hong Kong. We suggest the government consider other tax measures, such as (i) accelerating the deduction of capital expenditure for the purchase of copyrights, designs and trademarks; (ii) relaxing the criteria for deducting research and development (R&D) expenses; and (iii) introducing super deductions for R&D expenses for Profits Tax purposes.

Individuals

"Sweeteners" for middle class individuals

Despite the expectations of the middle class that the Budget would include more "sweeteners," given the surplus arising from better-than-expected Profits Tax and Salaries Tax revenue, the proposed tax reliefs are only similar to those offered in the 2015/16 Budget, including:

- A Salaries Tax and tax under personal assessment rebate of 75% (up to a ceiling HKD20,000) for final 2015/16 tax payable;
- An increase in the basic allowance, single parent allowance and married person's allowances;
- An increase in the dependent parent / grandparent allowances and elderly residential care expenses; and
- A rate waiver for four quarters of 2016/17, subject to a cap of HKD1,000 per quarter, for each rateable property.

Aging population

Supporting the elderly continues to be one of the cornerstone priorities of the government. To this end, the Budget proposes several short-term relief measures, including an extra Old Age Allowance, Old Age Living Allowance and Disability Allowance. An extra allowance also will be provided to recipients of Comprehensive Social Security Assistance that is equal to one month of the standard rate payments.

The government also announced the introduction of a "Silver Bond" that will target Hong Kong residents aged 65 or above, with the aim of providing steady return investments for the elderly, in addition to the other round of iBond issue. The "Silver Bond", with detailed terms to be announced, is expected to have higher guarantee yield than the recurring inflation-linked iBond.

Deloitte welcomes these measures, which may achieve short-term objectives. Long-term measures also are mentioned to address the challenges created by the aging population and the need to reduce poverty of the elderly. We are pleased that the government has held consultations on setting up a universal retirement scheme and we hope the government is able to find a solution that balances the need for retirement care and alleviating the monetary pressure on long-term expenditure.

Tax policy

The Financial Secretary mentioned a series of actions taken in recent years to modernize Hong Kong's tax legislation with a view to aligning the tax system with international standards and enhancing competitiveness. These actions include the Automatic Exchange of Information (AEOI) and implementation of Base Erosion and Profit Shifting (BEPS) actions. These are global trends that Hong Kong has to follow to maintain its competitiveness.

Although Hong Kong's low Profits Tax rate generally is considered one of its major competitive advantages in attracting foreign investment, a further reduction in the rate could help Hong Kong maintain its competitive edge vis a vis its regional rivals over the long term, at the cost of reducing tax revenue in the short term. It is hoped that the government will consider lowering the headline rate, or alternatively introducing a two-tiered taxation system with a lower tax rate for the first tier of assessable profits (say HKD2 million).

Despite concerns raised in the Budget that a structural deficit may arise due to the aging population and increasing government expenditure, the Financial Secretary did not mention broadening the tax base as in prior years. On the contrary, the proposed increase in allowances for Salaries Tax will narrow the tax base. We suggest the government conduct research on the pros and cons of imposing indirect taxes to increase government's revenue in the long run.

Comments

The 2016/17 Budget could be described as comprehensive for individuals, as it provides broad coverage of relief measures to the underprivileged, the working class and middle income earners. However, these relief measures are similar to measures in prior years. From a business perspective, although a visionary strategy has been set out to explore new markets and nurture innovation for achieving sustainable economic growth in the long-run, short-term relief measures are fewer-than-expected for businesses.

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