Deloitte. 德勤

Tax
Issue H101/2021 – 24 February 2021

Hong Kong Tax Analysis

2021-22 Budget Analysis

Pragmatic budget amid Hong Kong's record fiscal deficit paves way for post-pandemic recovery

The Financial Secretary of the Hong Kong Special Administrative Region, Paul Chan Mo-po, delivered his 2021-22 Budget speech today. This is the 5th budget prepared by Mr. Chan since his appointment as Financial Secretary.

The Financial Secretary forecasts the highest fiscal deficit in Hong Kong's history of HKD257.6 billion for the financial year (FY) 2020-21, against the backdrop of successive shocks including China-US tensions, local social incidents and the COVID-19 pandemic. This prompted a drastic decline in fiscal reserves to about HKD902.7 billion as of FY-end. The surge in the deficit for FY2020-21 from HKD37.8 billion in FY2019-20 was mainly due to relief measures via the Anti-epidemic Fund, sharp falls in revenue from land premium, and a rise in recurrent Government expenditure.

The 2021-22 Budget was prepared with a view to buffering the impact of economic recession on society and people's livelihoods, and paving the way for the post-pandemic economic recovery. Mr. Chan took a balanced approach in providing support for people's imminent needs amid the COVID-19 pandemic, while ensuring the stability of Hong Kong's public finances and financial system, and the sustainability of its economy. Similar to last year, the budget did not introduce many tax measures.

For a summary of the Budget measures, please see our *Hong Kong Tax Newsflash – Hong Kong 2021/22 Budget Highlights*. This article focuses on analyzing the tax-related proposals in the Budget.

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Key tax-related measures

One-off relief measures for individuals

The Financial Secretary again proposed a 100% reduction of salaries tax and tax under personal assessment for the year of assessment 2020-21, subject to a ceiling of HKD10,000 (reduced from 2019-20's HKD20,000), to ease individual taxpayers' burden.

There was however no proposal on increasing or broadening salaries tax allowances and deductions in this Budget, although we have suggested the Government introduce a residential rental expenses deduction, increase the basic and married person's allowances and extend the tax deduction for self-education expenses to enhance people skillsets and help them return to the labour market.

On the other hand, to stimulate the economy and facilitate the recovery of consumption, the Government will issue electronic consumption vouchers in instalments with a total value of HKD5,000 to each eligible Hong Kong permanent resident and new arrival aged 18 or above. Deloitte welcomes these measures, which can encourage and boost local consumption. Meanwhile, the Government will need to carefully consider the details of implementation, including how the elderly or Hong Kong permanent residents living outside Hong Kong can use the vouchers, whether the vouchers can be used for purchases from specific businesses most affected by the COVID-19 pandemic or broadly applied to all businesses, and the selection of electronic facilitation and platforms.

Tax relief for businesses

The Budget also reduced profits tax for 2020-21 by 100%, subject to a ceiling of HKD10,000 (reduced from HKD20,000 in 2019-20), to ease the burden of profits tax payers. Deloitte welcomes this measure to relieve the financial burden on businesses. Nevertheless, we hope the Government can further consider introducing a one-off measure to allow tax losses incurred in the year of assessment 2020-21 to be carried backward and offset against assessable profits generated in the 2018-19 and 2019-20 assessment years. This would provide cash flow assistance to businesses which made profits and paid tax in the last few years but are now suffering losses.

Asset and wealth management

With a view to developing Hong Kong into a preferred fund domicile, the Government has stepped up efforts to sharpen its competitive edge. In addition to the establishment of a limited partnership fund regime in August 2020, an amendment bill was introduced in early 2021 to provide tax concessions for carried interest issued by private equity funds operating in Hong Kong. Upon passage of the amendment bill, the relevant tax concession arrangement will apply from 2020/21. The Government is also preparing a legislative proposal to allow foreign open-ended fund companies (OFCs) or limited partnership funds (LPFs) to re-domicile to Hong Kong. We welcome these proposed measures, which will further enhance Hong Kong's attractiveness as an international asset and wealth management hub.

In addition, the Budget also suggested to provide subsidies to cover 70% (capped at HKD 1 million per OFC) of local professional service expenses incurred for OFC set up in or re-domiciled to Hong Kong in the coming three years. While we welcome this measure, it is recommended that the Government could consider extending the scope of this measure by covering LPF which is a more commonly adopted legal form for private equity or venture capital funds.

Family office business

To enhance Hong Kong's attractiveness as a hub for wealth management, the Government will offer one-stop support services to family offices interested in establishing a presence in Hong Kong, and will review related tax arrangements. As existing regimes for funds and fund management activities, such as the unified funds exemption regime, limited partnership funds regime and tax concession for carried interest, may not applicable to family offices, we hope the Government will consider providing preferential tax treatment or tax concessions to family offices investing through Hong Kong platforms.

Guangdong-Hong Kong-Macao Greater Bay Area (GBA)

Various schemes, including the Greater Bay Area Youth Employment Scheme, have been introduced to help Hong Kong businesses and youths grasp the opportunities arising from GBA development. Although this year's Budget touches only lightly on the GBA, more measures could be considered by the Government, such as providing transport subsidies to companies and their employees to further foster talent mobility across the GBA. We also suggest that the Government extend the deduction for dependent parent allowance and dependent grandparent allowance to parents and grandparents who are Hong Kong identity card holders and live primarily in the GBA, and the tax deduction for elderly residential care expenses related to residential care homes in the GBA. This would encourage more Hong Kong elderly to move to the GBA for their retirements, which is in line with Government policy.

Innovation and technology

Due to the COVID-19 pandemic, the global "stay-at-home economy" has stimulated digital businesses. The Budget provides several measures to promote innovation and technology, including nurturing talent and encouraging scientific research. We welcome these measures, although we believe more can be done from a tax perspective.

The Financial Secretary mentioned in the Budget that the existing enhanced tax deduction regime for R&D expenditure has delivered notable results in encouraging enterprises to devote resources to local R&D. Meanwhile, we suggest the Government further expand the scope of qualifying R&D projects to provide a more favorable tax environment for innovation- and technology-driven industries. At the same time, collaboration on technology and scientific research between Hong Kong and the Mainland has become a dominant trend. The Government could also offer tax incentives to key digital businesses that are collaborating within the GBA to pave the way for Hong Kong's economic recovery.

Tax policy

<u>Stamp duty on stock transfers</u>

The Budget proposes to raise the rate of stamp duty on stock transfers from the current 0.1 percent to 0.13 percent of the consideration or value of each transaction, payable by buyers and sellers. We understand that the Government needs to increase revenue during this difficult time, and the Financial Secretary considered the possible impact on the securities market and Hong Kong's international competitiveness before making this decision. We look forward to observing the effectiveness of this measure in increasing government revenue and the potential impact on the capital market.

Review of Hong Kong tax system

Despite the Budget not proposing any adjustment to profits tax and salaries tax rates, or the introduction of new taxes, the Government mentioned that it will keep in view the economic situation and make changes at the appropriate time. It will also research the introduction of new taxes to increase revenue in the long run. We are pleased that the Government is being forward looking in considering possible ways to increase revenue. We would recommend that it expedite the research and consultation process to prepare for the introduction of tax changes.

International tax cooperation

The international tax environment continues to change, with increasing emphasis on enhanced transparency and combating cross-border tax evasion. The Organisation for Economic Cooperation and Development is working on a proposal, commonly referred to as "BEPS 2.0", to further address base erosion and profit shifting risks among multinational enterprises. Although the details have yet to be finalized, these initiatives are expected to have a substantial impact on Hong Kong's tax landscape. The Financial Secretary outlined the direction of the Government's response as follows:

- Hong Kong will implement the BEPS 2.0 proposals.
- The Government will minimize the impact on local small and medium sized enterprises when drawing up the response measures.
- The Government will minimize the compliance burden on affected corporations.
- The Government will improve Hong Kong's business environment and enhance its competitiveness.

As expected, there were no concrete measure to address this issue in the current Budget, because it could involve profound reform of Hong Kong's tax system. Nevertheless, we are pleased the Government is being proactive in preparing for forthcoming international tax developments and challenges.

Concluding remarks

Overall, the Budget is a prudent yet practical one given Hong Kong's economy has contracted for two consecutive years and still has a long way to go for a full market recovery. Deloitte appreciates the Government's efforts to strengthen Hong Kong's competitiveness, especially in financial services and innovation & technology, and to pave the way for the post-pandemic economic recovery. However, we hope the Government will consider more tax measures to support the imminent needs of businesses and individuals during these difficult times. In the long-run, Hong Kong also needs to prepare for upcoming international tax reform. Although there are still many challenges and uncertainties ahead, we look forward to seeing the Government take the lead in Hong Kong's emergence from economic recession and towards the revitalization of the post-pandemic economy.

Tax Analysis is published for the clients and professionals of the Hong Kong and Chinese Mainland offices of Deloitte China. The contents are of a general nature only. Readers are advised to consult their tax advisors before acting on any information contained in this newsletter. For more information or advice on the above subject or analysis of other tax issues, please contact:

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