



Hong Kong Tax Newsflash

Introduction of enhancement measures for lease reinstatement costs and commercial/industrial building allowances

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The government has recently submitted proposals to the Legislative Council regarding tax deductions for lease reinstatement costs, as well as removal of time limit for claiming Commercial Building Allowance (CBA) and Industrial Building Allowance (IBA) following the announcements made during the 2024-25 Budget Speech.

Tax deduction for lease reinstatement costs

Currently, lease reinstatement costs are regarded as capital in nature and are therefore non-deductible. Nevertheless, these costs are effectively ordinary business expenses that must be incurred for leasing premises. As such, the government considers it justified to allow tax deductions for lease reinstatement costs, subject to the following conditions:

- Lease reinstatement costs must be actually incurred or paid. It also covers payments made by the lessee to the lessor for discharging the lessee's obligation to reinstate the leased premises, provided that the payments are reasonable. No deductions will be allowed for any provisions made on such costs.

- The lessee must be under an obligation to reinstate the leased premises to their original condition, regardless of whether this obligation is stipulated in the tenancy agreement or established through other arrangements (e.g., verbal agreement) between the lessor and the lessee.

Removal of time limit for claiming CBA and IBA

Currently, there is a 25-year time limit for claiming CBA and IBA, which begins from the year of assessment in which a building is first used. If a commercial/industrial building is sold after 25 years of use, the buyer will not be entitled to claim any CBA/IBA while the seller will be subject to a balancing adjustment. In other words, no capital expenditures could be deducted for a commercial/industrial building or structure that have been in use for more than 25 years.

To maintain the competitiveness of the CBA and IBA regimes in Hong Kong and foster a business-friendly environment, the government has proposed to remove the time limit for claiming CBA and IBA. Under the refined regime, CBA or IBA would be calculated on an annual basis at a rate of 4% on the cost of construction or the residue of expenditure¹ immediately after the sale until it is fully claimed.

The refined CBA and IBA regimes would align the tax treatment of capital expenditure incurred before and after the 25-year time limit, as well as first-hand and second-hand commercial/industrial buildings or structures.

Implementation timeline

It is anticipated that the proposed legislative amendments will be introduced into the Legislative Council for reading in the 4th quarter of 2024. Upon enactment, both enhancement measures will become effective from the year of assessment 2024/25.

Our observations

We welcome the introduction of these enhancement measures which would maintain the competitiveness of Hong Kong's tax system and provide relief for taxpayers. We are pleased to note that the government has taken into account the stakeholders' views and incorporated their comments in formulating the proposals.

The proposed tax deduction for lease reinstatement costs in Hong Kong appears to be more accommodating than the regime in Singapore. In Singapore, lease reinstatement costs are only deductible if they are contractually provided for in the tenancy agreement, and the premises must not be vacated due to the cessation of business. In contrast, Hong Kong's approach is more flexible, allowing deductions for costs incurred under verbal agreements or other arrangements, as well as lease reinstatement costs incurred upon the cessation of a business.

We look forward to the details of the regimes, especially the transitional issues in relation to IBA, when the draft legislation is released later this year.

¹ Residue of expenditure means the amount of capital expenditure incurred on the construction of the commercial/industrial building or structure reduced by the amount of any initial allowance, annual allowance and/or balancing allowance made, and increased by any balancing charge made.

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