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Hong Kong Tax

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2014/15 Budget Analysis: Visionary budget, cutting down "sweeteners" and few tax measures for individuals

The Financial Secretary for the Hong Kong Special Administrative Region (HKSAR), Mr. John Tsang Chun-wah, delivered his seventh budget on 26 February 2014. The 2014/15 Budget echoes the initiatives announced in the 2014 Policy Address, delivered by the Chief Executive, C.Y. Leung, in January that includes sustaining the economic growth of Hong Kong as a gateway for investment, supporting the disadvantaged and promoting the upward mobility of youth.

The 2014/15 Budget has been prepared under a moderate fiscal position with a less-than-expected revised surplus estimate of HKD 12 billion for 2013/14. The Budget is designed to develop Hong Kong's economy through the pillar industries (financial services, logistics, tourism and professional services), and at the same time, to provide a better social and economic environment for its population. While the Budget places considerable emphasis on controlling expenditure to save for the future, there are fewer "sweeteners" and tax measures for individuals as compared to previous budgets.

This analysis highlights the key proposals in the 2014/15 Budget and includes an appendix summarizing the proposed tax changes.

Long-Term Economic Development

The 2014/15 Budget re-emphasizes the importance of economic development through the four pillar industries and includes specific measures to accomplish this goal. For example, it is proposed to develop Hong Kong as a “smart city” in terms of information technology, enhance Hong Kong’s reputation as an international hub by building a new airport runway, upgrade tourist facilities by constructing several theme parks, etc. Various tax measures also are proposed to enhance financial services (see below).

We welcome the government's long-term vision to improve Hong Kong's competitiveness with concrete measures. To further unleash Hong Kong's competitiveness and thus increase revenue in the long-term at the potential expense of a temporary reduction in tax revenue, we would encourage the government to review the tax policy and explore options to (i) lower the profits tax rate; (ii) provide tax incentives for regional headquarters set up in Hong Kong; (iii) relax the rules governing deductions for research and development expenses for profits tax purpose; and (iv) continue to expand the tax treaty network.

Tax measures to enhance financial services

1. Interest deduction for group treasury companies

Hong Kong is a popular destination for multinational corporations to set up their regional or global financial and treasury management hubs. However, the existing rules that generally disallow a deduction for interest paid to overseas companies discourage the establishment of such group treasury hubs. The Financial Secretary announced that the interest expense deduction rules would be revisited and the criteria for deductions clarified with a view to attracting more financial activities in Hong Kong. Concrete proposals are expected to be announced within a year. Deloitte welcomes the Financial Secretary's decision to adopt our suggestions.

2. Extension of offshore fund exemption

In response to the proposal in the 2013/14 Budget that the profits tax exemption for offshore funds be extended to encompass private equity funds, the Financial Services Development Council issued a synopsis paper on 18 November 2013 setting out its key recommendations for the proposed extension and providing insight as to what the new law could look like. Industry commentators have suggested that the profits tax exemption and more flexible structures for offshore funds would help Hong Kong position itself as an international hub for the fund industry. On the other hand, the Financial Secretary said that regulatory frameworks for open-ended fund company structure have been drawn up and the government will proceed with the relevant consultation in the near future.

While we are pleased to see progress on the proposed extension of the offshore fund exemption and the open-ended fund company structure, we recommend that the government expedite the consultation process and implementation of the measures to attract more funds to Hong Kong.

3. Relaxing stamp duty exemption for exchange traded funds (ETFs)

There currently is a stamp duty exemption concession for the trading of ETFs that track indices comprising no more than 40% of Hong Kong stock. The 2014/15 Budget proposes to extend the concessionary exemption to the trading of all ETFs (including those with a higher percentage of Hong Kong stock in their portfolios) to promote the development, management and trading of ETFs in Hong Kong. Deloitte applauds this proposal.

Support for small and medium-sized enterprises (SMEs)

In addition to long-term economic development, we are pleased that the Budget can seek a balance to propose various concrete measures to support local SMEs in financing, market expansion, brand building and productivity enhancement. As a one-off relief measure to businesses in general, a 75% profits tax rebate, capped at HKD 10,000, is proposed for the final tax payable for year of assessment 2013/14. However, the budget does not contain a proposal to waive the business registration fee.

Combating tax avoidance and evasion

As was announced in last year's budget, the 2014/15 Budget reiterates that the Inland Revenue Department (IRD) will step up its efforts combat tax avoidance and evasion in order to prevent revenue losses on taxes and to recover tax due through effective use of information technology and international experience .

Caring for the elderly and the disadvantaged

The 2014 Policy Address contains concrete measures to alleviate poverty and assist the elderly and the disadvantaged; these measures include the introduction of a low-income working family allowance and an increase in the amount of health care vouchers. To ensure that the needs of the disadvantaged and low income earners are addressed, the following one-off inducements are proposed in the 2014/15 Budget:

- Granting an additional allowance to recipients of Comprehensive Social Security Assistance, the Old Age Allowance, the Old Age Living Allowance and the Disability Allowance that equals one month of the standard rate payments and allowances; and
- Paying one month's rent for public housing tenants (two months' rent in the 2013/14 Budget).

The relief measures that focus on helping the elderly, disadvantaged and low income earners are welcome. At the same time, it is proposed to increase tobacco duty as effective means to safeguard the health risks of the public and to strengthen the government's smoking cessation services. Deloitte also welcomes this measure.

Few measures for the middle class

Recent budget proposals have provided various one-off relief measures, such as salaries tax reductions, rates waivers, electricity subsidies, etc. Before the announcement of the 2014/15 Budget, the Financial Secretary hinted that such reliefs could be withdrawn as the global economy improved. These statements generated a considerable backlash by the middle class, who claimed their financial burdens were being ignored.

Taking the public's concerns into account, the 2014/15 Budget proposes a salaries tax and tax under personal assessment rebate of 75% (up to HKD 10,000) (the same as in the 2013/14 Budget) for final tax payable for year of assessment 2013/14, as well as a slight increase in the dependent parent/grandparent allowances. A rates waiver for the first two quarters, subject to a cap of HKD 1,500 per quarter, for each rateable property (in 2013/14, capped at HKD 1,500 per quarter for the full year) also is proposed. Noticeably absent from the 2014/15 budget are proposed electricity subsidies (HKD 1,800 in 2013/14). Realizing the government's plan to gradually reduce the one-off relief measures, some measures are cut and the capped amounts of certain reliefs are reduced as compared to the 2013/14 Budget. Nevertheless, we are pleased that the Financial Secretary will consider providing tax relief for subscribers of regulated insurance products after a consensus is reached in the community.

It appears that the middle class will not receive as many "sweeteners" as in prior years. While it is understood that the government takes a cautious approach in controlling expenditure and cutting one-off reliefs to save for the future, we suggest the introduction of an allowance for working couples (e.g. an allowance for a family where both spouses are employed) that effectively would alleviate the financial burden on the middle class and, on the other hand, encourage married women to re-join the work force and, therefore, strengthen the working population in Hong Kong.

Housing problems

Over the past two years, the government has introduced series of special measures on stamp duty for property transactions in an effort to curb speculation in the property market. Although some of the measures proposed more than a year ago, the controversial nature of many of the measures delayed the passing of the relevant bills by the Legislative Council last week. As these stamp duty measures have been digested by the market, it appears that Hong Kong housing prices have been stabilized, but not significantly held down — property prices remain high and unaffordable for the general public. The 2014/15 Budget does not contain any additional tax measures to address issues relating to property transactions. It is believed that the government wants to wait for a further market adjustment subsequent to the passing of the bills in the hope that housing prices will drop during 2014. The government will closely monitor the market fluctuation and adjust the stamp duty measures when appropriate. Nevertheless, in the meantime, we suggest that the government provide tax relief to ease housing expense burdens on the middle class, such as a deduction of stamp duty for property used as a principal residence and a refund of stamp duty where the property has been occupied for at least three years.

Future Fund

A "Future Fund" is introduced in the 2014/15 Budget which can be used to finance future strategic infrastructure projects at times of structural deficit arising from aging population and to address potential social challenges. Details of the implementation and usage of the "Future Fund" is awaited to be seen.

Conclusion

The 2014/15 Budget places a welcome focus on long-term economic development with specific measures for the pillar industries. On the other hand, it takes a cautious approach by controlling expenditure and cutting down one-off reliefs with a view to saving for the future. While the 2014/15 Budget can address the general welfare of the population and the commitment to resolving deep-rooted social issues, it may not be able to meet some people's expectation in terms of "sweeteners" and tax measures to relieve the middle-class's financial burden nor businessmen's expectation of profits tax rate reduction and tax incentives to encourage foreign investments. Overall, Deloitte appreciates that the government is taking an initiative to study the long-term fiscal planning to address with an ageing population under the current healthy financial position. We look forward to a bright future in which the government will implement the proposed measures to enhance Hong Kong's competitiveness.

Appendix – Summary of Allowances, Deductions & Tax Rates

Salaries Tax

Progressive Tax Rates (unchanged)

2013/14 and 2014/15	
Net chargeable income (HKD)	Marginal tax rate
First 40,000	2%
Next 40,000	7%
Next 40,000	12%
Remainder	17%

Standard Rate (unchanged)

2013/14 and 2014/15
15%

Allowances and Deductions

	2013/14 (HKD)	2014/15[1] (HKD)
Personal Allowances:		
Basic	120,000	120,000
Married	240,000	240,000
☐ Single Parent	120,000	120,000
Child:		
1st to 9th child		
Year of birth	140,000	140,000
Other years	70,000	70,000
Dependent Parent/Grandparent (aged 60 or above):		
Basic	**38,000**	**40,000**
Additional allowance (for each dependent living with taxpayer)	**38,000**	**40,000**
Dependent Parent/Grandparent (aged between 55-59):		
Basic	**19,000**	**20,000**
Additional allowance (for each dependent living with taxpayer)	**19,000**	**20,000**
Dependent Brother/Sister	33,000	33,000
Disabled Dependent	66,000	66,000
Deductions (maximum amount):		
Self-Education Expenses	80,000	80,000
Home Loan Interest	100,000 (15 years of assessment)	100,000 (15 years of assessment)
Elderly Residential Care Expenses	**76,000**	**80,000**
Contributions to Recognized Retirement Schemes	15,000	17,500
Approved Charitable Donations	35% of income	35% of income

One-Off Measure on Salaries Tax and Tax under Personal Assessment

Reduction of 75% of final tax payable under Salaries Tax and Tax under Personal Assessment for 2013/14, subject to a ceiling of HKD10,000, is proposed.[1]

1 Legislative amendments are required.

Profits Tax (unchanged)

	2013/14 and 2014/15
	Tax rate
Incorporated	16.5%
Unincorporated	15%

One-Off Measure on Profits Tax[2]
Reduction of 75% of final tax payable under Profits Tax for 2013/14, subject to a ceiling of HKD10,000 is proposed.

Property Tax (unchanged)

2013/14 and 2014/15
Tax rate
15%

Rates[2]

The Budget would waive rates for first two quarters of 2014/15, subject to a ceiling of HKD 1,500 per quarter for each rateable tenement.

[2] Legislative amendments are required.

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