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Tax Analysis

2017/18 Budget Analysis

Comprehensive, but cautious budget with commitment to review long-term tax policy

The Financial Secretary for the Hong Kong Special Administrative Region (HKSAR), Mr. Paul Chan Mo-po, delivered the 2017/18 Budget on 22 February 2017. This is the first budget prepared by Mr. Chan since his appointment as the Financial Secretary following the resignation of his predecessor, Mr. John Tsang Chun-wah, to run in the election for Chief Executive.

The 2017/18 Budget was prepared against a backdrop of local political uncertainty and increasing threats of a volatile global macro-economy surrounded by Brexit, the changing political landscape in Europe and a potential global trend towards trade protection measures. The 2017/18 Budget is designed to reinforce the competitiveness of Hong Kong's traditional pillar industries, and at the same time, introduce measures to promote the re-industrialization and diversification of industries, and nurture development in the financial services and asset/wealth management industry, the aircraft leasing business, the innovation and technology sector, etc., with a view to enhancing the competiveness of Hong Kong and achieving sustainable long-term economic growth.

The better-than-expected surplus of HKD 92.8 billion for FY2016/17, which is relatively close to Deloitte's estimate before the announcement of the Budget, mainly results from the higher-than-budgeted revenues from land sales and stamp duty. In view of this surplus, it is not surprising that the general public was anticipating the announcement of "sweeteners" and short-term stimulus measures. However, the Budget is considered relatively prudent and cautious, although the government's forward-looking vision as demonstrated in various proposed initiatives is welcomed.

This analysis highlights the key proposals in the 2017/18 Budget in the

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following areas:

Tax policy

A tax policy unit is proposed to be set up in the Financial Services and the Treasury Bureau to comprehensively examine the international competitiveness of the Hong Kong tax regime from a macro perspective, and the long-debated problem of Hong Kong's narrow tax base.

Deloitte has previously suggested the setting up of a specific tax policy unit. We appreciate the government's acknowledgement of the threats arising from the rapidly-changing global competitive environment, particularly the increasing use of tax concessions, enhancements of the adaptability and diversity of the taxation structure, corporate tax rate reductions, etc. contemplated by other countries. The tax policy unit hopefully can help pave the way to facilitate discussion and the eventual introduction of long-term tax reform measures.

We also welcome the government's expressed intention to align Hong Kong tax practices with the global efforts to counter money laundering and target tax base erosion and profit shifting via the tax policy unit to ensure that Hong Kong does not lag behind the international tax community.

We look forward to the wide-range consultations initiated by the government among various industries and professional bodies to invite public views and put forward more concrete tax reform measures (e.g. enhanced deductions for innovation and technology expenditure, as mentioned in the Budget speech) in the future. We hope the government will have a diverse mix of parties involved in the tax policy unit to ensure a forward-looking and comprehensive review and reform of Hong Kong's tax system.

Businesses

One-time relief measures for businesses

Similar to last year, the 2017/18 Budget continues to provide a tax rebate on profits tax of 75% (up to HKD20,000). We welcome this one-off relief measure, which will ease the burden of doing businesses in general.

Asset/wealth management

There also is a proposal to extend the existing profits tax exemption to onshore privately-offered open-ended fund companies. This is a welcome proposal which, further to the introduction of a legal, regulatory and tax framework for an open-ended fund company regime in Hong Kong in mid-2016, should attract funds to domicile in Hong Kong, and build up the capabilities and attractiveness of Hong Kong as an international financial hub. We look forward to the industry-wide consultation to be initiated by the government on the legislative proposals.

Aircraft leasing business

Global aviation passengers, particularly passengers in the Asia Pacific, are expected to grow over the next 20 years. New aircraft deliveries, both worldwide and in the Asia Pacific region, is valued in trillions of Hong Kong dollars, thus opening substantial business opportunities for financial and other professional services. Echoing the Policy Address announced in January 2017, the Financial Secretary mentioned in the Budget that the government plans to introduce a bill into the Legislative Council in 2017 to offer tax concession to aircraft financing business. Tax incentives for aircraft leasing recently were proposed to the Legislative Council, which involve granting a concessionary tax rate of 50% of the normal profits tax rate (i.e. 50% of 16.5%), and taxing only 20% of the gross rents less deductible expenses (excluding tax depreciation) derived by a qualifying aircraft lessor from the leasing of an aircraft to a non-Hong Kong aircraft operator. We welcome the government's long-term view about the expected growth in civil aviation, and its insight and determination in creating a dedicated tax regime to attract aircraft leasing business to Hong Kong.

Individuals

One-time relief measures

- Salaries tax and tax under personal assessment rebate of 75% (up to HKD 20,000);
- Waiver of rates for four quarters of 2017-18, subject to a ceiling of HKD 1,000 per quarter for each rateable property; and
- Extra allowance to social security recipients, equal to one month of the standard rate Comprehensive Social Security Assistance payments, Old Age Allowance, Old Age Living Allowance or Disability Allowance.

Recurrent tax measures

- Broadened marginal bands for salaries tax from HKD 40,000 to HKD 45,000. We expect that this also will apply to tax under personal assessment;
- Increase in the Disabled Dependant Allowance from HKD 66,000 to HKD 75,000;
- Increase in the Dependent Brother/Sister Allowance from HKD 33,000 to HKD 37,500;
- Extension of the entitlement period for the tax reduction for home loan interest from 15 years of assessment to 20 (with the deduction ceiling of HKD 100,000 per year maintained); and
- Increase in the deduction ceiling for self-education expenses from HKD 80,000 to HKD 100,000.

In addition to the above, the government will study and propose a tax deduction for the purchase of regulated health insurance products to encourage the use of private healthcare services by the public.

Deloitte welcomes the above measures, but would suggest the government consider a wider range of relief measures that could further relieve the burden on taxpayers, particularly the middle class. For example, the government could consider allowing a deduction for elderly residential care expenses to be claimed along with the Dependent Parent/Grandparent Allowance, introducing a deduction for children's education expenses, a working couple allowance and a deduction for expenses on salary to domestic helpers, etc. Such measures could further alleviate the financial burden on the working class and encourage individuals with family commitments to re-join the working population in Hong Kong.

Comments

This is the first budget delivered by the new Financial Secretary, Mr. Paul Chan, but the last one for the current-term government led by C.Y. Leung. Mr. Chan adopted a cautious approach, which is similar to his predecessor, Mr. Tsang. As expected, there are no exciting new initiatives, perhaps to leave room for the next government to bring in new initiatives. Nevertheless, this is a comprehensive budget, which can address the needs of different members of the population, as well as the long-term economic development of Hong Kong as a whole. Deloitte supports the government's vision to make use of the substantial surplus in some medium to long-term policies to resolve social problems and develop the economy, instead of providing one-off "sweeteners" to the public. We particularly appreciate that the government has adopted our suggestion to set up a tax policy unit for reviewing Hong Kong's tax policy in the long-run. We look forward to the current-term government implementing the measures in the Budget and the next government proposing initiatives to enhance Hong Kong's competitiveness and economic growth to provide a bright future for the next generation.

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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