

HONG KONG TAX ALERT

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Hong Kong introduces two tiered profits tax rate marking a push towards a more competitive tax environment

Summary

On 29 December 2017, the Inland Revenue (Amendment) (No. 7) Bill 2017 (Profits Tax bill) was gazetted, thereby introducing a two-tiered profits tax rate regime.

Its main objectives are to maintain a competitive taxation system to promote economic development, while maintaining a simple tax regime and low tax rates.

On 29 December 2017, the Inland Revenue (Amendment) (No. 7) Bill 2017 (Profits Tax bill) was gazetted ([click here](#)), thereby introducing a two-tiered profits tax rate regime.

The key objectives of the Profits Tax bill are to maintain a competitive taxation system to promote economic development, while maintaining a simple and low tax regime. The introduction of the two-tiered profits tax regime would:

- Reduce the overall tax burden on enterprises especially for small and medium enterprises;
- Allow enterprises to reinvest the tax savings in upgrading their hardware and software to boost their overall operations and efficiency;
- Enable the more successful social enterprises to pursue their social objectives (e.g., creating more employment and training opportunities for the socially disadvantaged) by alleviating their tax burden; and
- Boost Hong Kong's status as the preferred investment jurisdiction.

Two-tiered Profits Tax regime

The two-tiered profits tax regime will apply to both corporations and unincorporated businesses commencing from the year of assessment 2018/19 (i.e., on or after 1 April 2018). The applicable tax rates are as follows:

	Tax rate	
Assessable profits	Corporations	Unincorporated businesses
First HK\$2 million	8.25%	7.5%
Over HK\$2 million	16.5%	15%

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For corporations, the first HK\$2 million of profits earned by a company will be taxed at half the current tax rate (i.e., 8.25%) whilst the remaining profits will continue to be taxed at the existing 16.5% tax rate.

For unincorporated businesses, the first HK\$2 million of profits earned will be taxed at half of the current tax rate (i.e., 7.5%) whilst the remaining profits thereafter will be taxed at the existing 15% tax rate.

In order to avoid double benefits, the following enterprises shall be excluded from the two-tiered profits tax regime:

- enterprises electing the preferential half-rate tax regimes (e.g., professional reinsurance companies, captive insurance companies, corporate treasury centres and aircraft leasing companies); and
- the assessable profits for sums received by or accrued to holders of qualifying debt instruments as interest, gains or profits should already be taxed at half the rate (i.e., 7.5% or 8.25%, as the case may be).

There will be an anti-fragmentation measure to prevent corporate activities from being divided amongst a large number of companies who could benefit from the lower tax rate - each group will have to nominate only one company in the group of companies to benefit from the progressive rate.

Key amendments to the Inland Revenue Ordinance ("IRO")

The IRO will be amended to introduce the two-tiered profits tax regime. The main provisions of the Profits Tax bill are as follows:

Key amendments	Description
Section 14 (amended)	Charge to profits tax will be amended to apply for any year of assessment commencing on or after 1 April 2018. Profits tax is to be charged in accordance with the new Schedule 8A or 8B (see below)
Sections 14AA, 14AAB and 14AAC (new)	Section 14AA will include a definition of "entity" and "sole proprietorship business". Section 14AAB has defined an entity as a "connected entity" of another entity if: <ul style="list-style-type: none">• one of the entities has control over the other;• both entities are under the control of the same entity; or• in the case of the first entity being a natural person carrying on a sole proprietorship business – the other entity is the same person carrying on another sole proprietorship business. Section 14AAC provides that if two or more entities are connected, the two-tiered profits tax rates may apply to one of the entities only. In particular: <ul style="list-style-type: none">(a) for an entity other than a corporation, the tax is to be charged on the assessable profits of the person at the standard rate (i.e., 15% for unincorporated businesses)

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	<p>(b) for a corporation and a corporation that is a partner in a partnership, the tax is to be charged under Schedule 8B (see details below).</p>
Schedules 8A and 8B (new)	<p>Schedules 8A and 8B will be included for the charging of profits tax under the two-tiered profits tax rate system for corporations and unincorporated businesses. This applies to a year of assessment commencing on or after 1 April 2018.</p> <p>Section 1 of Schedule 8A applies to the charge of profits tax to persons other than corporations (i.e., unincorporated businesses):</p> <ul style="list-style-type: none"> (a) at the rate of 7.5% on the assessable profits from the trade, profession or business up to HK\$2 million; and (b) at the rate of 15% on any part of the assessable profits over HK\$2 million from the trade, profession or business <p>Section 2 of Schedule 8B applies to the charge of profits tax to a corporation (including partners in a partnership):</p> <ul style="list-style-type: none"> (a) <i>for a corporation</i> <ul style="list-style-type: none"> • at the rate of 8.25% on the assessable profits from the trade, profession or business up to HK\$2 million; and • at the rate of 16.5% on any part of the assessable profits over HK\$2 million from the trade, profession or business. (b) <i>for a corporation that is a partner in a partnership</i> <ul style="list-style-type: none"> • at the rate of 8.25% on the net share of assessable profits concerned up to the threshold. The threshold has been defined for a corporation that is a partner in a partnership to be HK\$2 million multiplied by the ratio at which the corporation shares the profits or losses of the partnership during the basis period for the year of assessment; and • at the rate of 16.5% on the net share of assessable profits concerned over the threshold.
Schedule 43 (new)	<p>Schedule 43 provides for transitional provisions in relation to the charging of provisional profits tax for the year of assessment commencing on or after 1 April 2018.</p> <p>In particular, an application for a hold over payment of provisional profits tax on an additional ground may be made where:</p> <ul style="list-style-type: none"> • a person who is liable to pay provisional profits tax in respect of the year of assessment 2018/19 may apply to the Commissioner in writing to have the tax payment, in part or whole, to be held over until the person is required to pay profits tax for the year. • an application may be made for the year of assessment 2018/19 if the person is, or is likely to

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	<p>be, chargeable to profits tax in accordance with Section 1 of Schedule 8A or Section 2 of Schedule 8B, under Section 14.</p> <ul style="list-style-type: none"> • This section does not affect the operation of Section 63J (holding over of the payment of provisional profits tax). <p>The written application must be made not later than the 28th day before the day by which the provisional profits tax is to be paid or by the 14th day after the date of the notice for payment of provisional profits tax.</p>
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KPMG observations

As global tax rates continue to fall, Hong Kong has to introduce new tax measures in order to remain competitive and attract foreign investment into Hong Kong. The Profits Tax bill is a welcome enhancement to small and medium enterprises in Hong Kong and to the Hong Kong tax system to maintain its position as Asia's leading international business centre.

The Profits Tax bill will be formally introduced into the Legislative Council on 10 January 2018. The IRO will be amended in order to introduce the two-tiered profits tax rate regime. KPMG will provide further commentary and insights upon the release of such amendment to the IRO.

For more information and assistance, please contact your usual tax advisor or one of our tax advisors below.

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