

HONG KONG TAX ALERT

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Hong Kong enacts a two-tier profits tax regime – effective from year of assessment 2018/19

Summary

Hong Kong recently introduced a two-tiered profits tax rate regime effective from year of assessment 2018/19.

This is a welcome tax incentive for businesses. Businesses with related entities will need to review their existing structures and nominate one member of their group to benefit from the reduced tax rate.

On 29 March 2018, the Inland Revenue (Amendment) (No. 3) Ordinance 2018 ("the Ordinance") was gazetted (click [here](#)), thereby introducing a two-tiered profits tax rate regime.

Two-tiered Profits Tax regime

The new regime applies to both corporations and unincorporated businesses. It will commence from the year of assessment 2018/19 (i.e., on a taxpayer's financial year ending between 1 April 2018 and 31 March 2019) as follows:

- For corporations, the first HK\$2 million of profits will be taxed at one-half of the current tax rate (i.e., 8.25%) and 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 will be taxed at one-half of the current tax rate (i.e., 7.5%) and the remaining profits will be taxed at the existing 15% tax rate.

There is an extensive definition of "connected entity" in the legislation which is designed to ensure that a group of connected taxpayers can benefit from the one-half reduction only in respect of one of such connected taxpayers. For this purpose, the group will need to identify which entity will benefit and to make an election accordingly. The election, once made, is irrevocable in respect of a particular year of assessment.

Taxpayers who have elected into other preferential half-rate tax regimes (e.g., professional reinsurance companies, captive insurance companies, corporate treasury centres and aircraft leasing companies) are excluded from the two-tiered tax regime.

In addition, any profits derived from qualifying debt instruments which are already taxed at concessionary tax rates (i.e., 7.5% or 8.25%, as the case may be) will be similarly excluded.

Provisional Profits Tax for connected entities

Going forward, provisional tax calculations will assume the reduced rate will apply. For groups, this calculation will apply to the entity which applied the reduced rate in the prior year. For the first year (i.e., the year of assessment 2018/19), in calculating provisional profits tax, a group of connected entities will need to file an election process to nominate one of its members to take advantage of the reduced rate. This appears to be separate from the election in respect of the final tax.

In the 2017/18 Profits Tax return (Form BIR51), an additional question has been included about whether the taxpayer is chargeable under the two-tiered regime for 2018/19 provisional profits tax purposes. Groups therefore must decide which group member should elect into the regime, although it appears that the final applicant can be determined when subsequently filing the 2018/19 tax return.

KPMG observations

This is a welcome tax incentive and no doubt will help relieve the tax burden for small and medium sized enterprises in particular.

It will be important for businesses with related entities (e.g., corporate groups) to review their existing structures as each group will have to nominate one member in the group to benefit from the reduced tax rate.

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

For further details of the two-tier profits tax regime, please see our previous [Hong Kong Tax Alert – Issue 1](#).

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