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Hong Kong Budget Summary 2012-2013

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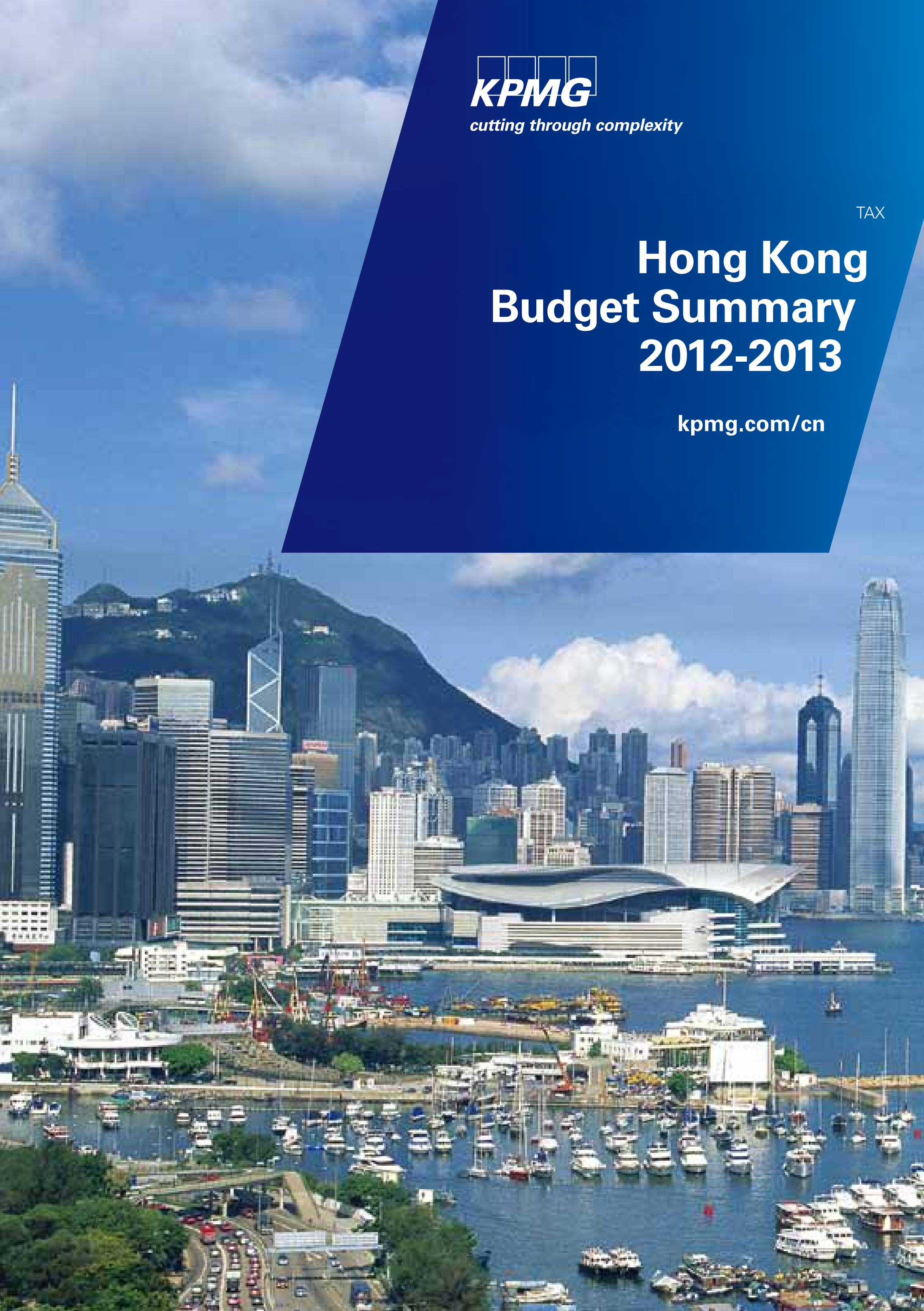

Hong Kong – challenges and opportunities ahead

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Hong Kong's economy is facing difficult challenges in 2012 with the Euro-zone debt crisis, economic slowdown in mainland China, softening domestic property prices and slack consumer demand. This makes it even more important for Hong Kong to implement reforms to enhance its competitive edge and leverage its existing competitive advantages. This is essential if Hong Kong wants to consolidate its position as an international financial, trade and shipping centre, a key objective of China's 12th Five-Year Plan.

These and other complementary measures will help to fully exploit the opportunities for Hong Kong from greater integration with the mainland economy. Moreover, the measure introduced on 14 October 2011 by the Ministry of Commerce and the People's Bank of China will enable enterprises making investments in the mainland to lower their risk of currency exchange as well as significantly increase the demand of Hong Kong and international enterprises for renminbi (RMB) financing. Enterprises can now make use of the RMB fund-raising platform in Hong Kong by financing direct investments in the mainland through banks, debt and equity. The measure also provides more investment channels for the growing pool of RMB funds in Hong Kong. This will further promote the development of the RMB bond and securities markets and expedite the development of the offshore RMB business in Hong Kong.

In Phase 1 of its Hong Kong Peer Review report of October 2011, the Global Forum of the Organisation for Economic Co-operation and Development (OECD) examined Hong Kong's legal and regulatory framework for accessing and exchanging information with foreign tax authorities. The report pointed out that, while Hong Kong has the necessary framework in place to exchange information, there is room for improvement in several areas.

The OECD commended Hong Kong for re-affirming its commitment to the international standards of tax transparency but noted that Hong Kong's current policy is to agree to exchange tax information only in the context of a comprehensive double taxation agreement (DTA) instead of entering into specific tax information exchange agreements (TIEAs). Given Hong Kong's importance as an international financial centre, the Global Forum considered it essential that Hong Kong enters into agreements (regardless of their form) that meet international standards with all relevant partners.

The Hong Kong government's response has been positive. While continuing its efforts to expand the DTA network, the Hong Kong government has signaled its intention to introduce legislation enabling Hong Kong to conclude TIEAs with all relevant partners. We can therefore expect interesting developments on this topic in the near future.

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Hong Kong Budget Summary

2012 - 2013

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Legislative proposals do not generally become law until their enactment and may be modified by the Legislative Council before enactment.

1 February 2012

It should be noted that the following information is presented in summary form and readers are advised to seek professional advice before formulating business decisions.

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Hong Kong Budget 2012-13

Introduction

The Financial Secretary, Mr John Tsang Chun-wah, delivered his fifth Budget speech, which is also the last Budget of the current-term Government, to the Legislative Council on 1 February 2012.

Despite the adverse effects of the financial tsunami in 2008, the Hong Kong economy started to improve in the second quarter of 2009 and then embarked on a full-fledged recovery in 2010. In the first quarter of 2011, the year-on-year Gross Domestic Product (GDP) growth was as high as 7.6 percent. However, as the global economic environment deteriorated rapidly, Hong Kong's GDP growth slowed down. As a whole, GDP only grew by 5 percent in real terms in 2011, which is at the lower range of the forecast made by the Financial Secretary in August 2011. The Government forecasts the GDP growth for 2012 to be between 1 to 3 percent only whilst the inflation rate for 2012 is estimated at 3.5 percent.

Despite the economic downturn, the Government accounts performed much better than predicted in the last Budget. The operating account and consolidated account surplus are estimated to be HKD 38.2 billion and HKD 66.7 billion respectively. By 31 March 2012, fiscal reserves are expected to be HKD 662.1 billion. For 2012-13, the Government forecasts a small Budget deficit of HKD 3.4 billion and fiscal reserves of HKD 658.7 billion by March 2013.

The Financial Secretary highlighted that, whilst relief measures are essential to help stabilise the economy and safeguard people's livelihood, it is also important to seize the opportunity to invest in the future. The Financial Secretary introduced measures worth nearly HKD 80 billion in the Budget to better prepare Hong Kong for the difficult times ahead and to also enhance Hong Kong's competitive edge.

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Profits Tax

Persons carrying on business in Hong Kong are liable to Profits Tax on profits arising in or derived from Hong Kong.

The Financial Secretary did not change the Profits Tax rates and allowances for 2012-13. However, a one-off reduction of 75 percent of Profits Tax for 2011-12 has been proposed, subject to a ceiling of HKD 12,000. The reduction will be reflected in taxpayer's final tax payable for 2011-12.

The Profits Tax rate for corporations will remain at 16.5 percent for 2012-13 and for unincorporated businesses, it will remain at 15 percent.

The rate of deeming assessable profits from royalty type payments for the use of intellectual property will remain at 30 percent or 100 percent as the case may be of the payment. Therefore, the effective tax rate on such payments will remain at 4.95 percent or 16.5 percent for 2012-13.

Capital allowances

The Depreciation Allowance rates for plant and machinery remain unchanged at:

Initial Allowance	:	60 percent of qualifying expenditure in the year the expenditure is incurred.
Annual Allowance	:	10 percent, 20 percent or 30 percent on the written down value brought forward depending on the category to which the asset belongs.

Industrial Building Allowances also remain unchanged at:

Initial Allowance	:	20 percent of qualifying expenditure.
Annual Allowance	:	4 percent of qualifying expenditure.

The Commercial Building Allowance on qualifying expenditure remains at 4 percent per annum.

A full deduction is available for certain capital expenditure, such as expenditure on computer hardware and software as well as for certain other types of expenditure, which would otherwise be treated as capital in nature and non-deductible.

The 100 percent Profits Tax deduction for capital expenditure on environmentally-friendly machinery and equipment in the first year of purchase and the five-year depreciation period for environmentally-friendly installations, which are mainly ancillary to buildings introduced in 2008-09 is retained. The 100 percent Profits Tax deduction for capital expenditure incurred on

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environment-friendly vehicles in the year of purchase, which became effective in 2010-11 is also retained.

Capital expenditure on the purchase of the following intangible assets are deductible (at various rates):

- patent rights or rights to any know-how; and
- registered trademarks, copyrights and registered designs (with effect from the year of assessment 2011/12).

Deductions for donations

The ceiling for tax deductible charitable donations remains at 35 percent of assessable profits for 2012-13.

Salaries Tax

The Financial Secretary has proposed a one-off reduction of 75 percent of Salaries Tax (and tax under personal assessment) assessed for 2011-12, subject to a ceiling of HKD 12,000. The reduction will be reflected in the final tax payable for 2011-12.

The tax charge for 2011-12 and 2012-13 is the lower of:

(a) net assessable income less charitable donations and allowable deductions at the standard rate; or

(b) net assessable income less charitable donations and allowable deductions and personal allowances, charged at the following progressive rates.

2011-12	Tax	HKD	2012-13	Tax	HKD
First HKD 40,000	2%	800	First HKD 40,000	2%	800
Next HKD 40,000	7%	2,800	Next HKD 40,000	7%	2,800
Next HKD 40,000	12%	4,800	Next HKD 40,000	12%	4,800
Balance	17%		Balance	17%	

The standard rate of Salaries Tax for 2011-12 and 2012-13 is 15 percent.

The Financial Secretary has proposed increases to a number of the personal allowances available when calculating the tax payable at the progressive rates, which are intended to support individuals and their families.

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Personal allowances

The personal allowances for 2011-12 and 2012-13 are set out below:

		2011-12 HKD	2012-13 HKD
Personal allowances	(basic)	108,000	120,000
	(married)	216,000	240,000
Single parent allowance		108,000	120,000
Child allowances	1st to 9th child (each)	60,000	63,000
Dependent parent allowance			
	(aged 60 or above)	36,000	38,000
	(aged between 55 and 59)	18,000	19,000
Dependent grandparent allowance			
	(aged 60 or above)	36,000	38,000
	(aged between 55 and 59)	18,000	19,000
Additional dependent parent and grandparent allowances			
	(aged 60 or above)	36,000	38,000
	(aged between 55 and 59)	18,000	19,000
Disabled dependant (spouse/child/parent/grandparent/ brother/sister) allowance		60,000	66,000
Dependent brother/sister allowance		30,000	33,000

In addition to the child allowance available annually, an additional one-off allowance is available for each child in the year of birth. The Financial Secretary has proposed that the additional allowance be increased from HKD 60,000 to HKD 63,000.

Applying the above Salaries Tax rates and allowances, a family of four will have to earn more than HKD 3,711,000 in 2012-13 before paying tax at the standard rate.

Tax deductions

The Financial Secretary has also proposed changes to a number of the tax deductions available in determining a person's Salaries Tax liability:

Mortgage relief

Home mortgage interest payments are deductible against income subject to Salaries Tax. Owner-occupiers may claim a deduction for mortgage interest payments up to a maximum of HKD 100,000 per year for one property. The Financial Secretary has proposed that the period the deduction can be claimed should be extended to 15 years (up from 10 years).

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Caring for the elderly

As an alternative to the allowance for maintaining a dependent parent/grandparent, a deduction is available for the expenses incurred maintaining dependent parents/grandparents in residential care. The Financial Secretary has proposed that the annual deduction ceiling for elderly residential care expenses be raised from HKD 72,000 to HKD 76,000.

Contributions to retirement schemes

A deduction up to the maximum of the mandatory annual contributions that would be payable under the Mandatory Provident Fund scheme is available for contributions made by employees to recognised retirement schemes and Mandatory Provident Fund schemes. The Financial Secretary has proposed that the deduction be increased from HKD 12,000 to HKD 15,000 per annum. This is a consequential amendment in light of the increase to the monthly cap on relevant income for mandatory contributions and will take effect from June 2012.

Self-education costs

A deduction up to a maximum of HKD 60,000 per annum is available for self-education expenses. The deduction is available in respect of fees for training courses run by approved institutions.

Charitable donations

A deduction of up to a maximum of 35 percent of assessable income is available for approved charitable donations.

Property Tax

The standard rate remains at 15 percent for 2012-13.

Property Tax is payable in addition to rates and is charged on the owner of any land or buildings situated in Hong Kong at the standard rate on the 'net assessable value' of such land or buildings. Generally, 'net assessable value' is calculated as the amount of rent receivable by the owner of the subject land or buildings (net of any rates which are paid by the owner) less a statutory 20 percent allowance for repairs and outgoings.

There are several exemptions, notably for corporations carrying on business in Hong Kong.

Rates

Rates on properties remain at 5 percent of the rateable value throughout the territory.

However, the rates for 2012-13 will be waived, subject to a ceiling of HKD 2,500 per quarter for each rateable property.

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Stamp Duty

Property transactions

No changes were proposed to the Stamp Duty rates and banding on property transactions. The Stamp Duty rates and banding for 2012-13 are set out below:

Property Consideration		
HKD	**HKD**	**HKD**
Exceeds	Does not exceed	
	2,000,000	100
2,000,000	2,351,760	100 + 10% of excess over 2,000,000
2,351,760	3,000,000	1.5%
3,000,000	3,290,320	45,000 + 10% of excess over 3,000,000
3,290,320	4,000,000	2.25%
4,000,000	4,428,570	90,000 + 10% excess over 4,000,000
4,428,570	6,000,000	3.00%
6,000,000	6,720,000	180,000 + 10% of excess over 6,000,000
6,720,000	20,000,000	3.75%
20,000,000	21,739,120	750,000 + 10% of excess over 20,000,000
21,739,120		4.25%

Moreover, on 19 November 2010, the Financial Secretary announced a new Special Stamp Duty (SSD) on transactions for residential properties in a bid to address perceived concerns over increases in property prices.

SSD is imposed on the sales price or market value of the property as at the date of sale (whichever is higher) at the following penal rates, depending on when the property is bought and sold.

Property holding period	
6 months or less	15%
more than 6 months but not exceeding 12 months	10%
more than 12 months but not exceeding 24 months	5%

The SSD is effective for residential properties acquired on or after 20 November 2010 and resold within 24 months and is in addition to the *ad valorem* rates of Stamp Duty already imposed (up to 4.25 percent). Both the seller and the buyer will be jointly and severally liable for paying the SSD.

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Sales and purchases of Hong Kong stock

No changes were announced to the rate of Stamp Duty payable in respect of transfers of Hong Kong stock. This remains at an aggregate *ad valorem* rate of 0.2 percent of the actual consideration or the value of the stock as at transfer date, whichever is higher.

Other Points of Interest

Relief measures

The Financial Secretary announced several relief measures to help ease the pressure brought about by the economic downturn. These measures include:

- Waiving rates for 2012-13, subject to a ceiling of HKD 2,500 per quarter for each rateable property
- Granting a subsidy of HKD 1,800 to each residential electricity account
- Paying two months' rent for public housing tenants
- Providing an extra allowance, equal to one month's payment, to recipients of Comprehensive Social Security Assistance and Old Age Allowance and Disability Allowance
- Halving the charges for import and export declarations
- Abolishing capital duty
- Waiving business registration fees for 2012-13
- Allocating HKD 100 million to extend short-term food assistance services, if necessary
- Giving all student loan borrowers who complete their studies in 2012 the option to start repaying their student loans one year after completion of their studies.

Hong Kong as a global economic, financial and commercial centre

The Financial Secretary announced that efforts will be increased to further reinforce Hong Kong's position as a global economic, financial and commercial centre. The Government will conduct market consultation on the legislative proposals on the development of Islamic finance in the first quarter of 2012 and introduce the amendment bill into the Legislative Council in the next session.

To assist Hong Kong enterprises in capturing the opportunities arising from the National 12th Five-Year Plan in a more focused manner, a dedicated fund of HKD 1 billion will be set up to help Hong Kong enterprises tap into the Mainland market by restructuring and upgrading their operations, developing their brands and expanding domestic sales in the Mainland.

The Government will continue discussions on entering into agreements for the avoidance of double taxation with trading and investment partners, such as Canada and South Korea. The Government will also continue to attract overseas companies, especially those from emerging markets, to list in Hong Kong.

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iBonds

Further to the issuance of iBonds last year, the Government will launch additional iBonds worth not more than HKD 10 billion in 2012-13 to Hong Kong residents. The maturity period of the iBonds will be three years and interest will be paid to bond holders once every six months at a rate linked to the inflation of the last half-year period.

Microfinance

The Financial Secretary announced that the Hong Kong Mortgage Corporation (HKMC) will introduce a three year pilot 'Microfinance' scheme to help people who wish to start their own business, self-employed persons and people who wish to receive training to enhance their skills or obtain professional qualifications for self-improvement. The maximum loan amount of the pilot scheme will be capped at HKD 100 million and a maximum repayment period of five years.

Support for Small and Medium Enterprises (SMEs)

To help SMEs get through the difficult times in an economic downturn, the Government will continue to support SMEs by enhancing the existing SME Financing Guarantee Scheme, which was launched by the HKMC in 2011. In particular, the maximum loan guarantee ratio will be increased from 70 percent to 80 percent for which the Government will provide a guarantee commitment of HKD 100 billion.

The Government has also pledged its continued support to SMEs through the Hong Kong Export Credit Insurance Corporation (HKECIC). In 2012, HKECIC will offer new policy terms, which will include special concessions for SME policyholders who will be allowed to insure their exports only for places and buyers of their choice, and will be entitled to various premium discounts.

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KPMG's commentary

The Financial Secretary presented the 2012-13 Budget off the back of the current global economic uncertainty and the Euro-debt crisis that has engulfed capital markets world-wide. Despite the difficult economic environment, the Government has yet again defied their Budget forecast by recording a consolidated Budget surplus of HKD 66.7 billion for 2011-12. In last year's Budget, the Government predicted a Budget surplus of HKD 3.9 billion (subsequently revised to a deficit of HKD 8.5 billion after additional measures were announced on 2 March 2011) for the year.

The Financial Secretary noted that Hong Kong's economy had remained resilient throughout the year. However, he cautioned that a number of challenges remained, highlighting the sharp decline in exports experienced in the 2011-12 year. Nevertheless, Hong Kong did manage to achieve strong economic growth for the year. Real GDP growth for 2011 came in at 5 percent; although this is expected to slow down over the coming year. GDP is forecast to grow between 1 to 3 percent for the 2012 year. The broad range reflects the uncertainty that exists in global markets, which may impact Hong Kong's economy.

Hong Kong's fiscal reserves remain strong and are estimated to be HKD 658.7 billion by the end of March 2013, representing approximately 34 percent of GDP and equivalent to 20 months of Government expenditure. The Government has returned to a more measured approach of sharing the strong economic performance with the community after the controversial backtrack last year which led to the HKD 6,000 cash hand out to Hong Kong permanent residents.

One-off relief measures for 2012-13 include a one-off reduction of Salaries Tax of 75 percent, with a ceiling of HKD 12,000, a waiver of rates capped at HKD 2,500 per quarter for each rateable property and a subsidy for each residential electricity account of HKD 1,800. For businesses, the Financial Secretary proposed a one-off reduction of Profits Tax of 75 percent, with a ceiling of HKD 12,000, a waiver of business registration fees, the halving of charges for import and export declarations and the abolishment of capital duty levied on local companies. Although the Government has also announced some benefits for the less advantaged members of the community, the rest of the community may still feel short-changed.

To facilitate the stable development of the property market and meet the needs of Hong Kong's social and economic development, the Government will stabilise land supply. In particular, it will increase the supply of business sites by introducing measures such as 'Energising Kowloon East', revitalising industrial buildings and relocating Government departments from core business districts. The Government will also invite the Urban Renewal Authority to launch projects on the redevelopment of industrial buildings in the form of a pilot scheme.

As in previous years, there appears to be a lack of a central theme to this year's Budget. While the Government reaffirmed its support for the four pillar industries - Trading and Logistics, Financial Services, Business and Professional Services and Tourism - no clear guidance was given as to the form this support would take and how it would be implemented. In particular, the Government has again avoided the subject of tax incentives to encourage investment in key

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focus areas, which has been the approach of other jurisdictions in the region. It is also unclear what non-tax initiatives are being used to promote investment in these areas or to otherwise provide Hong Kong with a competitive advantage.

The Government's cautious approach is not unexpected in light of the wider, global uncertainty that continues to pervade capital markets. The Euro-debt crisis continues to unfold, with concerns that it could lead to a global financial crisis more severe than that experienced in 2008. There is also an on-going concern about domestic inflationary pressures caused by the strength of the domestic property market, abundant liquidity, low interest rates and a continuing influx of capital into Hong Kong. Measures put in place in prior years to rein in speculative activity, including the introduction of additional stamp duties, and the tightening of the loan-to-value ratio for mortgage lending, remain in effect.

Against this, the Government is focused on stimulating the domestic economy to boost employment in Hong Kong. To this end, measures to increase public spending have been proposed, including expenditure on large-scale projects such as the Hong Kong section of the Guangzhou-Shenzhen-Hong Kong Express Rail Link, the Hong Kong-Zhuhai-Macao Bridge, the Central-Wan Chai Bypass, railway construction works of the South Island Line (East) and the West Island Line, and Shatin to Central Link project. These are all positive moves, which should be welcomed by industry groups.

Surprisingly, however, the Government has not gone further. Indeed, the Financial Secretary specifically referred to requests to introduce group loss relief and loss carry-back arrangements, as well as tax concessions for specific sectors or enterprises. However, these requests were dismissed in light of various factors such as whether the proposals would further narrow Hong Kong's tax base and restrict the source of tax revenue to a handful of enterprises, thereby making Hong Kong's tax revenue unstable. Despite the reference made to the danger of relying on a narrow tax base, little indication was given as to how the Government intended to broaden the tax base. It has now been several years since the last detailed review of the Hong Kong tax system and the associated decision not to implement a value added tax system. The time may be right to re-visit this proposal again.

On the whole, the Budget was broadly in line with expectations and very much a continuation of what we have seen in prior years. While in many ways, it is a very cautious Budget, this is, perhaps, unsurprising given the global and domestic economic environment at present, as well as the political changes that will come from mid-2012.

1 February 2012

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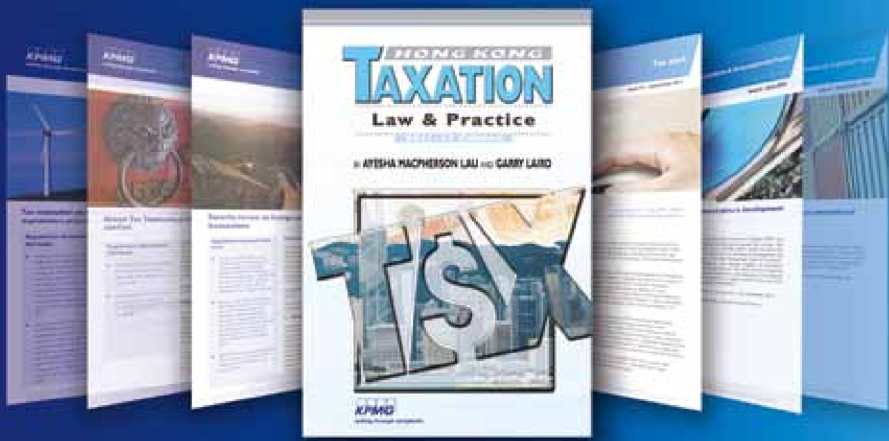
Annual Guide to Hong Kong Taxation 2011-12 edition

Celebrating its 30th anniversary, this concise and informative guide is co-authored by Ayesha M. Lau and Garry Laird of KPMG China's Hong Kong office and is published annually by the Chinese University Press.



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