cutting through complexity

TAX

HONG KONG BUDGET SUMMARY 2014-2015

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2014 - Challenges and Opportunities

Five years after the global financial crisis, the world economy is showing signs of recovery albeit at a slower than expected pace. Most economists are convinced that tepid growth will continue to characterise the world economy in 2014. Challenges still remain as key market players undergo major economic and political changes. For example, China expects its rate of economic growth to slow down to around 7 percent as it transitions from a growth model based on investment and exports to one led by domestic consumption and innovation.

Hong Kong, whose economy remains closely entwined with China, experienced a stable recovery with its GDP forecast at about 3 percent in 2013, up from 1.5 percent in 2012. Unemployment and inflation rates remain comparable with 2012 at 3.2 percent and 4.3 percent, respectively.

Hong Kong's economy was again ranked as the world's freest for the 20th consecutive year by the U.S.-based Heritage Foundation. The Hong Kong Government remains committed to maintaining this status and has already implemented a number of initiatives to ensure that Hong Kong remains a leading centre for trade, investment and financial services.

The Hong Kong Government has announced new tax policies for captive insurance, Islamic financing and asset management, all aimed at enhancing Hong Kong's standing as a major provider of financial services. It is also examining the proposals submitted by the Financial Services Development Council on Hong Kong's opportunities and challenges in RMB business, asset and wealth management and real estate investment trusts in collaboration with financial regulators.

Hong Kong continued to expand its Double Taxation Agreements (DTAs) network. As at January 2014, Hong Kong has concluded 29 DTAs, including 11 with its top 20 trading partners. Hong Kong is also in negotiation with a number of countries to conclude Tax Information Exchange Agreements.

On the international tax front, the difficult economic realities in recent years brought about increased discussions over tax morality and transparency. In 2013, the G20 economies, through the OECD, have identified Base Erosion and Profit Shifting (BEPS) as a serious risk to global tax revenues, sovereignty and fairness. The OECD released the BEPS Action Plan in July 2013 which identified specific actions that will give governments the domestic and international instruments to prevent corporations from paying little or no taxes. With an aggressive completion target of 18 to 24 months, we expect this issue to dominate the tax debate in the next few years.

Ayesha M. Lau
Partner in charge, Tax
Hong Kong SAR, KPMG China

Hong Kong Budget Summary 2014 - 2015

The information contained in the 2014-15 Hong Kong Budget Summary is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

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

26 February 2014

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.

Hong Kong Budget 2014-15

KPMG's commentary

In the 2014-15 Budget, the Financial Secretary makes it clear that, some 16 years after the return to China, Hong Kong is at a critical juncture. He highlighted significant developments made to date and proposes an array of measures designed to enhance Hong Kong's competitiveness, foster growth in the economy, increase employment opportunities and maintain public finances.

On the domestic front, the Financial Secretary noted that Hong Kong remained resilient amid the challenges facing the global economy in 2013. Key metrics such as economic growth of 2.9 percent for the year (versus 1.5 percent in 2012), an average headline inflation rate of 4.3 percent and an unemployment rate of 3.3 percent tend to support this comment.

The Government has forecast a revised consolidated budget surplus of HKD 12 billion for 2013-14 off the back of higher than estimated Government revenue and lower than estimated Government expenditure. A lower than anticipated Profits Tax revenue (8.8 percent less than originally estimated) was offset by higher than estimated land sales (21.9 percent higher than originally estimated) and Salaries Tax revenue (7.8 percent higher than originally estimated). Fiscal reserves are expected to reach HKD 745.9 billion by 31 March 2014.

In highlighting key external economic considerations, the Financial Secretary cited tepid recovery in the US and Europe while affirming his view that China's robust economy is the driving force of economic growth in the region and underpins the Hong Kong economy. Hong Kong must be prepared to withstand the inevitable volatility while adapting to the underlying changes in the global landscape to open up opportunities for future development.

A key theme of the Budget was competitiveness. In this regard, the Financial Secretary highlighted initiatives to bolster Hong Kong's position as an international hub, the promotion of the pillar industries, the keys and limits to development and fiscal sustainability.

In addressing Hong Kong's position as an international hub, the Financial Secretary said it was important to enhance transport networks and financial infrastructure. In addition, some of the key components of the strategy, published previously as part of the "Digital 21 Strategy", to develop Hong Kong as a smart city were noted. The Financial Secretary saw the need to make Hong Kong a more liveable city through investment in environmental infrastructure to ensure cleaner air, cleaner sea water and better treatment of solid waste.

We have previously suggested possible initiatives to further entrench Hong Kong's position as a global or regional hub, including incentives for global/regional headquarters and/or service centres. These initiatives do not appear to be on the agenda at present.

The promotion of industries has been a theme of previous budgets and was again in focus this year. The Innovation and Technology industry, in particular, was singled out with the pursuit of innovation and making good use of technology highlighted to facilitate the development of industries and help raise the productivity of all sectors. Grants and other forms of funding have been the preferred method of facilitating this, rather than enhanced deductions for research and development expenditure.

The contribution of the four pillar industries to employment and overall GDP was once again acknowledged, along with a need to continue supporting them. Indeed, the Financial Secretary stated that the Trading and Logistics, Financial Services, Tourism and Business and Professional Services industries are the linchpin of Hong Kong's economy.

Progress made in terms of supporting the Financial Services industry, in particular, was highlighted. Mention was made of developments in consolidating Hong Kong's position as the world's largest offshore renminbi business centre as well as the progress made in extending the offshore funds exemption for private equity business and the introduction of open-ended investment companies to attract more funds business. New initiatives announced include proposals to waive Stamp Duty on all exchange traded funds and to encourage the establishment of treasury functions in Hong Kong. These are all positive moves.

Support for SMEs, described as the mainstay of Hong Kong's economy and employment market, was affirmed and a series of measures announced.

As a key to development, the Financial Secretary focused on manpower – in particular the importance of investing in people – as well as measures to address the demand for land in the short, medium and long terms. A further key consideration identified was the ageing population in Hong Kong and associated matters such as elderly services and healthcare. We welcome the significant focus in these areas.

Public finances were another area of focus. The Financial Secretary commented on the health check undertaken by the Working Group on Long Term Fiscal Planning which was convened in 2013. The Working Group found that the Government's overall fiscal position in the short to medium term remains healthy but, in the longer term, the Government must seek to foster economic growth, and align the growth rates of the Government revenue and Government expenditure.

Key recommendations of the Working Group include preserving, stabilising and broadening the revenue base, as well as controlling public expenditure at or around 20 percent of GDP. Saving for the future, including the possible establishment of a 'Future Fund', is also a welcome initiative as a means of investing surplus revenues for future needs.

In terms of preserving the tax base, the Financial Secretary announced the Government would be stepping up its enforcement of the tax rules to combat tax evasion and avoidance. This announcement is perhaps a reference to the OECD's global initiatives on Base Erosion and

Profit Shifting to tackle perceived abusive tax arrangements and demonstrates Hong Kong's commitment to being a responsible member of the international community with respect to fiscal matters and combating tax evasion.

That said, while a focus on preserving the current revenue base is admirable, the Financial Secretary is clearly reluctant to engage in a public debate on expanding the tax base. We would welcome such a debate and would like to see it extended to other tax-related initiatives that have long been advocated by KPMG and other stakeholders such as group loss relief and loss carry back.

While no specific tax reductions were announced, proposed one-off relief measures included a Salaries Tax reduction of up to 75 percent, capped at HKD 10,000. The Government also proposed a waiver of property rates for the first two quarters capped at HKD 1,500 per quarter, paying one month's rent for public housing tenants and providing an extra allowance to Comprehensive Social Security Assistance recipients. In addition, an increase in the allowances available for those with dependent parents and grandparents was announced.

For businesses, the Financial Secretary proposed a one-off reduction of Profits Tax of up to 75 percent, with a ceiling of HKD 10,000.

We agree with the Financial Secretary's view that one-off measures such as rates waivers and tax rebates should only be offered subject to economic and financial conditions, rather than as recurring expenditure.

We also welcome the proactive measures being taken by the Government to tackle the challenges of an ageing population and proposed measures to increase Hong Kong's competitiveness. We now look forward to the Government providing detailed guidance on the implementation of the very positive messages contained in the Budget and some very welcome initiatives to drive the economy forward in the future.

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 2014-15. As in previous years, a one-off reduction of 75 percent of Profits Tax for 2013-14 has been proposed, with a ceiling of HKD 10,000. The reduction will be reflected in the taxpayer's final tax payable for 2013-14.

The Profits Tax rate for corporations will remain at 16.5 percent for 2014-15 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 of the payment, as the case may be. Therefore, the effective tax rate on such payments will remain at 4.95 percent or 16.5 percent for 2014-15.

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 has been retained 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. The 100 percent Profits Tax deduction for capital expenditure incurred on environmentally friendly vehicles in the year of purchase, which became effective in 2010-11, has also been retained.

Capital expenditure on the purchase of the following intangible assets is 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 2014-15.

Salaries Tax

The Financial Secretary has proposed a one-off reduction of 75 percent of Salaries Tax (and tax under personal assessment) for 2013-14, subject to a ceiling of HKD 10,000. The reduction will be reflected in the final tax payable for 2013-14.

The tax charge for 2013-14 and 2014-15 is the lower of the:

(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:

2013-14	Tax	HKD	2014-15	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 2013-14 and 2014-15 is 15 percent.

The Financial Secretary has proposed an increase in allowances for maintaining dependent parents or grandparents when calculating the tax payable at progressive rates. This is intended to alleviate the financial burden on taxpaying providers. No other changes to personal allowances were proposed.

Personal allowances

The personal allowances for 2013-14 and 2014-15 are set out below:

		2013-14 HKD	2014-15 HKD
Personal allowances	(basic)	120,000	120,000
	(married)	240,000	240,000
Single parent allowance		120,000	120,000
Child allowances	1st to 9th child (each)		
	- Year of birth	140,000	140,000
	- Other years	70,000	70,000
Dependent parent allowance			
	(aged 60 or above)	38,000	40,000
	(aged between 55 and 59)	19,000	20,000
Dependent grandparent allowance			
	(aged 60 or above)	38,000	40,000
	(aged between 55 and 59)	19,000	20,000
Additional dependent parent and grandparent allowances			
	(aged 60 or above)	38,000	40,000
	(aged between 55 and 59)	19,000	20,000
Disabled dependant (spouse/child/parent/grandparent/ brother/sister) allowance		66,000	66,000
Dependent brother/sister allowance		33,000	33,000

Applying the above Salaries Tax rates and allowances, a family of four will have to earn more than HKD 3,830,000 in 2014-15 before paying tax at the standard rate.

Tax deductions

The following items are deductible 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 deduction can be claimed for up to 15 years.

Caring for the elderly

As an alternative to the allowance for maintaining a dependent parent/grandparent, a deduction is available for the expenses incurred in maintaining a dependent parent/grandparent in residential care. The Financial Secretary has proposed that this deduction is increased from HKD 76,000 to HKD 80,000 for the year of assessment 2014-15.

Contributions to retirement schemes

A deduction up to the maximum of the mandatory annual contributions payable under the Mandatory Provident Fund scheme is available for contributions made by employees to recognised retirement schemes and Mandatory Provident Fund schemes. The maximum amount of deductible contributions will be HKD 17,500 for the year of assessment 2014-15 and HKD 18,000 for the year of assessment 2015-16 onwards.

Self-education costs

A deduction is available for self-education expenses. The deduction is available in respect of fees for training courses run by approved institutions. The maximum amount of deductible expenses for 2014-15 is HKD 80,000.

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 2014-15.

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, although rates for the first two quarters will be waived in 2014-15 subject to a ceiling of HKD 1,500 per quarter for each rateable property.

Stamp Duty

Property transactions

No changes were proposed to the Stamp Duty rates and banding on property transactions in the budget. On the basis of the changes announced on 22 February 2013 (which are yet to be enacted), the banding for 2014-15 will be as follows:

Property Consideration		
HKD	**HKD**	**HKD**
Exceeds	Does not exceed	
	2,000,000	1.5%
2,000,000	2,176,470	30,000 + 20% of excess over 2,000,000
2,176,470	3,000,000	3.0%
3,000,000	3,290,330	90,000 + 20% of excess over 3,000,000
3,290,330	4,000,000	4.5%
4,000,000	4,428,580	180,000 + 20% excess over 4,000,000
4,428,580	6,000,000	6.00%
6,000,000	6,720,000	360,000 + 20% of excess over 6,000,000
6,720,000	20,000,000	7.5%
20,000,000	21,739,130	1,500,000 + 20% of excess over 20,000,000
21,739,130		8.5%

Lower rates may apply to Hong Kong permanent residents on the purchase of their only residential property.

In addition, Special Stamp Duty (SSD) is imposed on the sales price or market value of the property as at the date of sale (whichever is higher). SSD was originally introduced with effect from 20 November 2010. However, with effect from 27 October 2012, SSD is imposed at the following penal rates, depending on when the property is bought and sold:

Property holding period	
6 months or less	20%
More than 6 months but not exceeding 12 months	15%
More than 12 months but not exceeding 36 months	10%

The SSD is effective for residential properties acquired on or after 20 November 2010 (with the current rates effective from 27 October 2012) and resold within 24 months and is in addition to the *ad valorem* rates of Stamp Duty already imposed (up to 8.5 percent). Both the seller and the buyer will be jointly and severally liable for paying the SSD.

A further Buyer's Stamp Duty at 15 percent is payable on purchases of residential property by non-natural persons, or natural persons not permanently resident in Hong Kong.

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 the transfer date, whichever is higher.

An extension to the Stamp Duty concession for exchange traded funds (ETFs) was announced. Previously the extension only applied to ETFs tracking indices comprising not more than 40 percent of Hong Kong stocks. This will now be extended to the trading of all ETFs.

Other Points of Interest

Relief measures

Similar to last year, the Financial Secretary announced several one-off relief measures to meet the aspirations of different sectors. These measures include:

- Paying one month's base rent for public housing tenants who are required to pay extra rent to the Housing Authority; and
- Providing an extra one month's allowance to recipients of Comprehensive Social Security Assistance and Old Age Allowance, Old Age Living Allowance and Disability Allowance.

Strengthening Hong Kong as a premier international asset management centre

To attract more private equity funds to domicile in Hong Kong, the Financial Secretary in his 2013-14 Budget proposed to extend the Profits Tax exemption for offshore funds to include transactions in private companies. In this Budget, the Government advised that it had completed an industry consultation and will commence the legislative work shortly.

To attract more traditional mutual funds and hedge funds to domicile in Hong Kong, the regulatory frameworks for introducing an open-ended fund company structure have been drawn up and consultation will begin in March 2014.

In addition, to attract more global or regional treasury functions to Hong Kong and to enhance our strengths in financial and professional services, the Financial Secretary proposed having the Financial Services and the Treasury Bureau set up a task force in collaboration with the Hong Kong Monetary Authority. The task force will review the requirements under the Inland Revenue Ordinance for interest deductions available to corporate treasury activities, and clarify the criteria for such deductions.

iBond

The Government will issue further inflation-linked retail bonds (iBond) of up to HKD 10 billion with a maturity of three years. Similar to the last financial year, this issue will target Hong Kong residents. Interest will be paid to bond holders once every six months at a rate linked to the inflation rate of the last half-year period.

Support for Small and Medium Enterprises (SMEs)

The Financial Secretary proposed to continue to assist SMEs under the challenging external environment in various areas, including:

- Extending the application period for the special concessionary measures under the SME Financing Guarantee Scheme for one year to the end of February 2015
- Continuing the implementation of the Small Business Policy (SBP) scheme by the Hong Kong Export Credit Insurance Corporation. SBP policyholders will continue to enjoy a waiver of the annual policy fee and up to 20 percent premium discount
- Earmarking HKD 50 million to support retailers on a matching fund basis for the use of IT and other technology solutions to increase productivity
- Promoting cloud computing applications among SMEs and providing training to help them adopt appropriate and affordable IT solutions
- Continuing with the Hong Kong Mortgage Corporation Limited's Microfinance Scheme
- Continuing to make use of the dedicated fund and extending the network of the Hong Kong Trade Development Council Design Gallery to assist Hong Kong enterprises in developing brands, in upgrading and restructuring, as well as in exploring market opportunities in the Mainland
- Continuing to identify suitable workspaces for individuals and enterprises engaging in creative industries and helping promote their work.

Support for research and development (R&D) activities

The Financial Secretary proposed boosting R&D investments and enhancing the commercialisation of R&D results by:

- Setting up an Enterprise Support Scheme (ESS) to replace the Small Entrepreneur Research Assistance Programme. The ESS will provide funding support for the R&D activities of private sector companies, irrespective of size, with the funding ceiling for each project raised from HKD 6 million to HKD 10 million
- Extending the scope of funding to development work and system integration, industrial design, compliance testing, and clinical trials
- Having the Innovation and Technology Fund provide annual funding of up to HKD 24 million to the six designated universities to provide seed money for R&D projects that they recommend.

Public Finances

- The Working Group on Long Term Fiscal Planning was set up last June to explore ways for Hong Kong's public finances to cope with the ageing population and long-term fiscal commitment. The Working Group performed a health check on the current state of the Government's long-term fiscal position up to 2041-42 and will be releasing the results in early March 2014.
- The Working Group recommends that the Government implement a combination of measures including:

  (1) Containing expenditure growth – The Government should control public expenditure at or around 20 percent of GDP.

  (2) Preserving Revenue Base – The Government should preserve, stabilise and broaden the revenue base. Although there may be little room for major tax hikes, the Government does not rule out any means to increase tax revenue. However, any new taxes will not be proposed without thorough consideration and public discussion. The Inland Revenue Department is also tightening enforcement to protect any revenue loss.

  (3) Saving for the future – The Working Group recommends that Government considers setting up a 'Future Fund'. This 'Future Fund' may be deployed in the event of sustained budget deficits to finance infrastructure projects conducive to Hong Kong's future economic development.

Contacts

For enquiries relating to this booklet or other tax matters, please contact any of the following KPMG tax professionals:

Khoon Ming Ho
Partner in charge, Tax
China and Hong Kong SAR
+86 (10) 8508 7082
khoonming.ho@kpmg.com

Ayesha M. Lau
Partner in charge, Tax
Hong Kong SAR
+852 2826 7165
ayesha.lau@kpmg.com

Chris Abbiss
Partner
+852 2826 7226
chris.abbiss@kpmg.com

Darren Bowdern
Partner
+852 2826 7166
darren.bowdern@kpmg.com

Barbara Forrest
Principal
+852 2978 8941
barbara.forrest@kpmg.com

Daniel Hui
Principal
+852 2685 7815
daniel.hui@kpmg.com

Charles Kinsley
Principal
+852 2826 8070
charles.kinsley@kpmg.com

John Kondos
Partner
+852 2685 7457
john.kondos@kpmg.com

Alice Leung
Partner
+852 2143 8711
alice.leung@kpmg.com

Curtis Ng
Partner
+852 2143 8709
curtis.ng@kpmg.com

Kari Pahlman
Principal
+852 2143 8777
kari.pahlman@kpmg.com

Murray Sarelius
Principal
+852 3927 5671
murray.sarelius@kpmg.com

John Timpany
Partner
+852 2143 8790
john.timpany@kpmg.com

Wade Wagatsuma
Partner
+852 2685 7806
wade.wagatsuma@kpmg.com

Lachlan Wolfers
Partner
+852 2685 7791
lachlan.wolfers@kpmg.com

Jennifer Wong
Partner
+852 2978 8288
jennifer.wong@kpmg.com

Christopher Xing
Partner
+852 2978 8965
christopher.xing@kpmg.com

Karmen Yeung
Partner
+852 2143 8753
karmen.yeung@kpmg.com

Kate Lai
Director
+852 2978 8942
kate.lai@kpmg.com

Alex Lau
Director
+852 2143 8597
alex.lau@kpmg.com

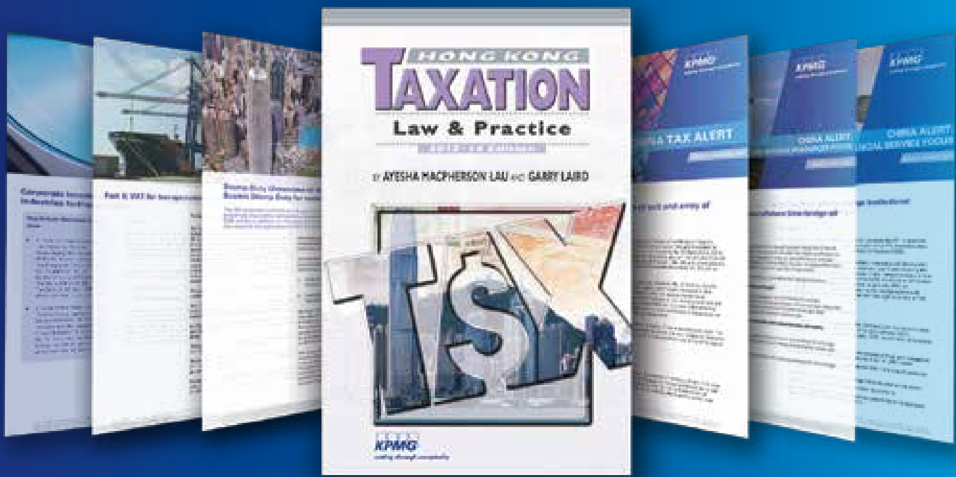
Benjamin Pong
Director
+852 2143 8525
benjamin.pong@kpmg.com

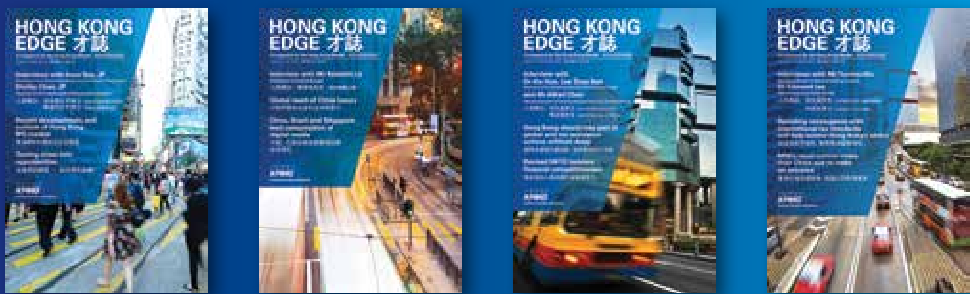
Adam Zhong
Director
+852 2685 7559
adam.zhong@kpmg.com

Garry Laird
Senior Tax Advisor
+852 2143 8795
garry.laird@kpmg.com

Justin Pearce
Senior Tax Advisor
+852 2143 8756
justin.pearce@kpmg.com

KPMG China, together with the Chinese University Press, has published the latest edition of Hong Kong Taxation: Law and Practice. This straightforward and accessible guide to Hong Kong's tax regime is co-authored by Ayesha M. Lau and Garry Laird from KPMG China's Hong Kong office.





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