

By Email (budget@fstb.gov.hk)

Budget Consultation Support Team
24/F, Central Government Offices
2 Tim Mei Avenue
Tamar
Hong Kong

14 February 2018

Dear Sir/ Madam,

2018-19 Budget Proposals

BDO Hong Kong is pleased to provide the following suggestions on the 2018-19 Budget.

Year 2018-19 will be a challenging year with no doubt. There are lots of changes not only in the Hong Kong tax regime but also in other jurisdictions, such as global trends of reducing tax rates. The impact of these changes on the Hong Kong economy is yet to crystallize. While Hong Kong has committed to maintain a simple and low tax regime, which is one of the key factors leading to our success today, further tax incentive measures should be considered in order to attract investments amidst the constantly evolving international economic climate. At the same time, our surplus is likely to set another record high, and we do hope to see tax measures that can improve the livelihood of the whole community. Our proposals to enhance Hong Kong's tax competitiveness and maintain a strong community are as follows:

A. Enterprises

1. Reduce Profits Tax rate

Following reduction in tax rates in other countries/jurisdictions, Hong Kong's competitive advantage is gradually declining. For instance, the UK reduced their corporate tax rate from 20% to 19% in 2017 and aims to further reduce it to 17% by 2020, and as of 2018 the US has reduced their federal corporate tax rate from 35% to 21%. While the proposed two-tiered Profits Tax rates regime will reduce tax burden on enterprises, in particular small and medium enterprises, further reduction will help foster a more favourable business environment as a whole and enhance Hong Kong's competitiveness in the region. We propose to reduce the Profits Tax rate for corporations to 16% for 2018/2019, with further cuts of 0.5% each year over the next two years to gradually lower the tax rate to 15% by 2020/21.

2. Enhance tax certainty

The statutory time limit for the Inland Revenue Department ("IRD") to raise an assessment or additional assessment is generally 6 years. Also, there is no time limit for the IRD to adjust a taxpayer's tax loss position. Therefore, taxpayers have to live with the uncertainty of whether their tax position should be considered final, particularly loss companies. Tax certainty is crucial to stimulate economic growth and promote investment. Uncertainty in the tax position will no doubt give rise to additional tax administrative burden on taxpayers and affect the decision of whether to invest in Hong Kong. There are also practical considerations such as a relatively more fluid workforce and high cost in maintaining historical records in a costly operating environment. In Singapore, the statutory time-bar period has been reduced from six years in 2008 to four years. To streamline tax administration and enhance Hong Kong's tax certainty, we propose to shorten the statutory time-bar period to four years and finalising the tax loss status also within four years.

3. Relax the conditions on Research and Development (“R&D”) expenditure deduction

We welcome the new measures proposed by the Chief Executive in her maiden policy address that the first HK\$2m of qualifying R&D expenditure would enjoy a 300% tax deduction with the remainder at 200%. Currently, section 16B of the Inland Revenue Ordinance (“IRO”) requires the activities to be conducted in-house by the taxpayer or payments made to approved research institutes in Hong Kong for any R&D expenditure to be deductible. If the R&D work is outsourced or the R&D expenditure is not paid to an approved research institute, no tax reduction is allowed. Nowadays, it is not uncommon for multinational corporations to centralise the R&D functions in one constituent entity as local approved institutes may not have the industry expertise and knowledge to suit the requirements of the taxpayers. While the group entity in Hong Kong would potentially derive taxable income from the benefits of the R&D work, it is not entitled to claim any R&D costs recharged as deductible expenses under the current regime. Unless there is a relaxation of the criteria in qualifying R&D expenditure, the effectiveness of the new measure proposed by the Chief Executive to promote innovation and technology business in Hong Kong would be undermined. We recommend that all expenditure incurred on R&D activities, whether in-house or outsourced to related/unrelated parties, should be allowed as tax deduction.

4. Promote Green Industries

People have become more aware of the importance to protect our environment. We propose the Government should formulate a comprehensive policy and provide subsidies/allowances to green industries, e.g. recycle industry. Currently, section 15(1)(c) of the IRO deems any sums received by or accrued to a person by way of grant, subsidy or similar financial assistance in connection with the carrying on of a business in Hong Kong as taxable receipts. We propose to amend section 15(1)(c) to exclude Government’s subsidy granted to green industries from taxable receipts in order to encourage more people to engage in such industries.

B. Livelihood

1. Reduce progressive rates for Salaries Tax and Personal Assessment

The proposed two-tiered profits tax regime would reduce the overall tax burden on individuals carrying on sole-proprietorship businesses and enterprises. Taxpayers deriving employment income and electing for personal assessments are not able to enjoy this reduced tax regime. We recommend that the Government lowers the progressive rates for Salaries Tax and Personal Assessment as follows to alleviate the economic burden of taxpayers, in particular the middle class, to cope with the escalating living costs in Hong Kong. The proposed 0% rate for the first HK\$45,000 band will also save the IRD’s administrative costs in issuing Salaries Tax assessments to taxpayers whose tax payable would be about HK\$1,000 or less, as around 580,000 taxpayers fell into this category for the year of assessment 2015/16.

	Net Chargeable Income	Current tax rate	Proposed tax rate
On the first	HK\$45,000	2%	0%
On the next	HK\$45,000	7%	5%
On the next	HK\$45,000	12%	10%
Remainder		17%	15%

2. Deduct rent paid on private housing

Taxpayers are entitled to claim deduction of home loan interest incurred on loans taken to finance the purchase of dwellings used as place of residence. The maximum deduction is HK\$100,000 per annum for 20 years. Taxpayers who lease private housing as their place of residence, however, cannot enjoy such preferential deductions. As the price of properties stands high, we estimate more and more people including the middle class may rent instead of buy. We propose to allow, on a similar basis, deduction of rent paid by qualified taxpayers on

private housing occupied as place of residence. Taxpayers can opt to claim deduction on either home loan interest or rent paid on private housing during the 20-year period. The maximum amount of deduction for rental payment for each year remains at HK\$100,000. This measure would reduce rent-paying taxpayers' tax burden and also be seen as fair policy.

3. Deduct medical insurance premiums

Aging population is one of the major factors that increase the stress on government expenditure for healthcare and social welfare service. The Chief Executive has proposed in her policy address to provide tax deduction for purchase of regulated health insurance products under the Voluntary Health Insurance Scheme ("VHIS"). We suggest that tax deduction should also be given for private medical insurance premiums in order to encourage the public to prepare for their own medical expenses in the future, reducing pressure on the public healthcare system. We recommend granting an annual deduction for private medical insurance premiums capped at HK\$16,000 for each person other than the VHIS.

4. Deduct expenses to maintain parents

Many taxpayers no longer reside with their parents after getting married or moving out for other practical reasons (e.g. small living space or distance from work), and yet they continue to support their parents' living by paying for their parents' place of residence (either rent or mortgage payments) and hiring domestic helpers to take care of their parents. As the population of Hong Kong ages, the public are under increasing pressure to take care of aging/aged parents. Under the current tax legislation, only taxpayers who reside with parents continuously throughout the whole year are entitled to additional dependent parent allowance. Taxpayers who pay fees to residential care homes for parents may claim a maximum deduction of HK\$92,000 for elderly residential care expenses although they do not reside with their parents. However, taxpayers who do not reside with their parents but pay for their parents' living and domestic helpers are not entitled to any additional allowance. We propose a deduction of expenses (e.g. rent/mortgage payments and expenses to hire domestic helpers etc.) incurred by taxpayers to take care of parents who do not reside with the taxpayers. Same as deduction for elderly residential care expenses, the maximum deductible expenses is capped at HK\$92,000. This measure helps relieve financial burden on taxpayers who maintain their parents. It also provides a degree of incentive to encourage people to support their aging/aged parents.

5. Deduct costs of employing domestic helpers

To cope with the high living costs in Hong Kong, particularly housing expenses, many middle class families need to have both spouses/parents take up full-time jobs leaving them with limited options but to hire domestic helpers to take care of the elderly and children at home. Often, one of the spouses/parents in a family that could not afford the cost of a domestic helper has to compromise and either stay home or struggle between household responsibilities and a part-time job. To reduce the burden of middle class and to attract more people joining the labour force which could reduce the problem of labour shortage in Hong Kong, we suggest granting a deduction equal to the actual wage for employing one domestic helper, capped at amount equivalent to the minimum wage of HK\$4,410 per month, for each household in order to relieve the financial pressure on the middle class.

We would be pleased to discuss the above proposals further should you wish. Please contact the undersigned at 2218 3232 or agnescheung@bdo.com.hk, or Carol Lam, our Director, at 2218 8296 or carollam@bdo.com.hk.

Yours faithfully,
For and on behalf of
BDO Tax Limited

A handwritten signature in black ink, appearing to read 'Agnes Cheung', written in a cursive style.

Agnes Cheung
Director, Head of Tax

AYC/CYL/BY/MK