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Dear Sir/ Madam,

2019-20 Budget Proposals

BDO Hong Kong is pleased to present the following suggestions on the 2019-20 Budget.

Hong Kong is one of the most competitive economies in the world. We appreciate the Government's commitment in promoting diversified economic growth with a view to broadening the economic base as well as adopting forward-looking and strategic financial management principles in wisely using our accumulated fiscal surpluses. In view of the uncertainties and challenges in the coming year, it is of utmost importance for Hong Kong to continue to maintain its simple and low tax regime and, at the same time, further improve our competitiveness to attract investments. Our proposals to enhance Hong Kong's tax competitiveness and maintain a strong community are as follows:

A. Enterprises

1. Reduce profits tax rate

The two-tiered profits tax rates regime has taken effect from 1 April 2018. It is the HKSAR Government's intention to target the benefit of this regime primarily for small and medium enterprises, and hence it is restricted to only one entity within a group of connected entities. To attract larger corporations/groups of entities amid the global trend of tax rates cut, we propose to reduce the profits tax rate for corporations to 16% for 2019-20, with further cuts of 0.5% each year over the next two years to gradually lower the tax rate to 15% by 2021-22. This will help foster a more favourable business environment as a whole and enhance Hong Kong's competitiveness in the region.

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 enterprises that sustain tax losses. 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 their desire 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 is 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 Government’s introduction of tax measures to promote R&D activities to be carried out in Hong Kong. The percentage of the enhanced deductions for certain R&D expenditure whereby the first HK\$2M of qualifying R&D expenditure would enjoy a 300% tax deduction with the remainder at 200% is generous. However, the conditions to be met in order to qualify for deductions under the old section 16B and the new section 16B of Inland Revenue Ordinance (“IRO”) remain largely the same and are rather stringent. A taxpayer can only obtain deductions on (part of) its in-house expenditure, payments to Hong Kong or overseas universities and colleges as well as payments to designated local research institutes. No deductions are available for expenditure on outsourcing R&D activities to entities other than designated local research institutes.

Nowadays, it is not uncommon for multinational corporations (“MNCs”) to centralise R&D functions in one constituent entity partly for confidentiality reasons and partly because local approved institutes may not have the industry expertise and knowledge to suit the requirements of the taxpayers. While the group operating 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. We recommend the criteria for qualifying R&D expenditure be relaxed to include all outsourced R&D activities or at least to allow tax deduction under a cost sharing arrangement. Further, we strongly encourage the Government to accept designation of MNC groups’ R&D entities in Hong Kong as designated local research institutes for tax purposes. Otherwise, it would be difficult to attract enterprises to invest in R&D activities.

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.

In addition, capital expenditure incurred on environmentally friendly machinery and equipment is currently deductible in the year of purchase and that on renewable energy and energy-efficient building installations is deductible over five years. To further encourage adoption of these expenditures to make Hong Kong more liveable, we propose that a super tax deduction (similar to that for R&D expenditures) be given.

B. Livelihood

1. Reduce progressive rates for Salaries Tax and Personal Assessment

Currently, the basic allowance and married person’s allowance granted to individual taxpayers is HK\$132,000 and HK\$264,000 respectively. There has been no adjustment to these allowances since the year 2016-17. We propose to increase the basic allowance and married person’s allowance to HK\$148,000 and HK\$296,000 respectively and also widen the first three bands from HK\$50,000 each to HK\$55,000 to alleviate the economic burden of taxpayers.

We also recommend 0% rate for the first band to 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 713,000 taxpayers fell into this category for the year of assessment 2016-17.

2. Deduction for tuition fees for health and sports related courses

The Government spends a substantial portion of its budget on public healthcare system every year. With our aging population, the demand for public healthcare may only increase unless the public become more vigilant for their health and wellbeing. To encourage more people to learn about health related knowledge and practical tips for their wellbeing, we suggest granting a deduction up to HK\$8,000 per annum for tuition fees spent by taxpayers in attending health and sports related courses. With the Government's commitment in putting more resources in promoting and encouraging health education, Hong Kong will become a healthier city and hopefully this could reduce our public healthcare expenditure in the long run.

3. 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.

4. Deduct expenses to maintain 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\$100,000 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\$100,000. 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

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. 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\$4,520 per month, for each household in order to relieve the financial pressure on the middle class.

6. Deduct costs of children education

It has aroused public concern about Hong Kong's aging population and low birth rates in the recent decade. Some researchers suggest that the young couples are reluctant to have children due to high cost of raising a child in Hong Kong. Although there has been upward adjustment in child allowance over the past years, e.g. the child allowance will be increased from HK\$100,000 to HK\$120,000 with effect from the year 2018-19, the ever increasing cost of raising a child, in particular education cost for those who are studying in private schools, outweighs the increment in child allowance.

We propose to introduce a deduction for child education expenses subject to a ceiling by reference to the subsidy currently provided by the Government to the aided schools and public schools.

We hope the above proposals are acceptable to you.

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



Agnes Cheung
Director, Head of Tax

AYC/CYL/BY/MK