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2018/19 Hong Kong Budget Commentary

Overview

On 28th February, 2018, Mr. Paul M Chan, the Financial Secretary of Hong Kong, delivered his second budget speech at the Legislative Council.

Parallel to the dynamic growth of the global economy, the Hong Kong economy has been observed a notable GDP growth of 3.8% for the year 2017 as a whole, which is much higher compared with the GDP growth of 1.9% last year and is the fastest growth in the last six years. However, due to the increase of interest rate by the United States Federal Reserve and the possible changes in the current loose monetary stances of central banks in major economies, the global monetary environment further complicates. Under the Pegged Exchange Rate System, the interest rate in Hong Kong is expected to rise eventually, and local asset prices and economic sentiments would possibly become volatile in the foreseeable future. In line with the recovery of the economy, the labour market has reached a state of full employment. Total employment sustained a moderate growth and the seasonally adjusted unemployment rate stayed at a nearly 20-year low of 3%. As the external price pressure and the increase in local costs remain low, the underlying inflation further decreased to averaging 1.7% for 2017, which is 0.6% lower than 2016.

Notwithstanding the growth in major economies, the economic outlook for the near future remains uncertain. The United Kingdom ("UK") has made its decisive move and invoked Article 50 of the Lisbon Treaty to detach from the European Union ("EU") by 29th March, 2019. The ongoing negotiations on the terms to Brexit and the future economic relationship between the UK and the EU continue to bring unpredictable impacts on the global economy. In addition, the increasing geopolitical tensions and the raise of protectionist sentiment over the world continue to bring more uncertainties to the economic environment, from which Hong Kong cannot stay immune.

The budget surplus of 2017 is HKD138 billion, which is HKD121.7 billion higher than the original estimated budget surplus of HKD16.3 billion. As mentioned in the budget this year, the Government adopts forward-looking and strategic financial management principles in optimising the use of surplus to invest for Hong Kong and relieve our people's burdens. In order to enhance Hong Kong's overall competitiveness and improve people's livelihood, the budget has proposed the following relief measures:-

Highlights

	Proposed fiscal/ tax measures
1	Increase tax reduction from 100% to 300% for the first $2 million of qualifying Research & Development expenditure, the remainder will be increased to 200% tax reduction
2	Widening the tax bands for salaries tax from the current $45,000 to $50,000, increasing the number of tax bands from four to five, and adjusting the marginal tax rates to 2%, 6%, 10%, 14% and 17% respectively from 2018/19 onwards
3	Reducing profits tax, salaries tax and tax under personal assessment for 2017/18 by 75 per cent, subject to a ceiling of $30,000
4	Increase the allowances for maintaining a dependent parent or grandparent aged between 55 and 59 to $25,000 and aged 60 or above to $50,000 from 2018/19 onwards
5	Increase the basic and additional child allowances to $120,000
6	Waive rates for four quarters of 2018/19, subject to a ceiling of $2,500 per quarter

	Policies for long-term development
1	Extend the scope of tax exemption for debt instruments to instruments of any duration
2	To encourage the trading and logistics industry to move up the value chain, the Government will cap the charge for each declaration at $200
3	To attract the establishment of corporate treasury centres, the Inland Revenue Ordinance will be further amend to extend the coverage of profits tax concession to specified treasury services provided by qualifying corporate treasury centres to all their onshore associated corporations.

Introduction

Under the pressure of the Organisation for Economic Co-operation and Development ("OECD") and to avoid being blacklisted by the international community, the Hong Kong Government has started to lodge the Minimum Standards proposed by the OECD with the aim to combat Base Erosion and Profit Shifting ("BEPS") and international tax evasion. As such, following the enactment of the Inland Revenue (Amendment) (No.3) Ordinance in 2016, Hong Kong has commenced to implement the AEOI that is in compliance with the Common Reporting Standard set out by the OECD. Moreover, the Inland Revenue (Amendment) (No.6) 2017 ("Amendment Bill No.6") was introduced into the Legislation Council for further reading on 10th January, 2018, which mainly seeks to codify certain transfer pricing principles into the Inland Revenue Ordinance ("IRO") and to implement key actions arising from the OECD's agenda.

Automatic Exchange of Information ("AEOI")

What is AEOI

AEOI is a new international standardized system that requires the financial institutions to submit certain information of the financial accounts held by tax residents of the AEOI reportable jurisdictions to the Inland Revenue Department, who will then exchange the information with the tax authorities of the reportable jurisdictions on an annual basis. The information to be shared include:-

1) Particulars of the account holder - name, address, jurisdiction of residence, taxpayer identification number and etc.;
2) Account number and account balance as at the end of the specified information period or other appropriate reporting period;
3) For a custodial account – total gross amount of interest, dividends, proceeds from sale or redemption of financial assets paid to the account; and
4) For a depository account – total gross amount of interest paid to the account.

The first exchange will take place in 2018. Up to now, there are 75 reportable jurisdictions with Hong Kong, including Japan, Mainland of China, Canada, the UK and etc. Furthermore, the Hong Kong Government is seeking to amend the IRO in order to pave the way for Hong Kong's participation in multilateral tax conventions, which will further expedite the expansion of Hong Kong's AEOI network.

Impacts of AEOI to taxpayers

After the launch of AEOI, it is expected that the tax authorities in different jurisdictions will be more active in challenging the tax position of the taxpayers after obtaining the financial account information of their tax residents from other jurisdictions which is not available to them before, especially for those taxpayers who derive income and hold financial accounts in multiple jurisdictions. In general, whether or not an individual is a tax resident of a jurisdiction is determined by having regard to the person's physical presence or stay in a place (e.g. whether over 183 days within a tax year) or, in the case of a company, the place of incorporation or the place where the central management and control of the entity is exercised. However, different jurisdictions have different variations in the definition of the tax residency in their respective laws. As such, it is possible that a taxpayer may become tax resident in more than one jurisdiction, which may cause it to face challenges from multiple tax jurisdictions.

In order to minimize the risk of tax sanctions, it is advisable for taxpayers to review their tax residency position and ensure correct tax filings in jurisdictions where taxable incomes derived. For incomes that may be taxable in multiple jurisdictions, taxpayers could apply for tax credit relief under the elimination of double taxation provisions contained in the double taxation arrangements concluded with respect to the tax jurisdiction where it is a tax resident. For additional tax payable arising from challenges by tax authorities of past years, the Hong Kong Government has proposed to extend the time limit for claiming tax credit to the end of 6 years after the end of the year of assessment; or the end of 6 months after the date on which an assessment is made imposing liability or additional liability to tax in respect of the income on which foreign tax has been assessed, whichever is the later.

Suggestions to taxpayers

With AEOI becoming the worldwide reporting standard, it is recommended that companies having dispatched employees to other tax jurisdictions or carrying on multinational operations to review their human resource and tax policies in order to mitigate potential risk.

As employers, companies should consider providing assistance to their dispatched employees in coping with the new AEOI reporting standard, including determining their tax residency status and preparing individual income tax returns in both of their home and dispatched jurisdictions, if applicable. Additionally, it is advisable for employers to consider setting up a proper tax package or assisting the dispatched employees in applying for tax credit claims in the tax jurisdiction where the employees are tax residents, especially under circumstances where double taxation would arise due to secondment by the employer. Upfront and clear communication and preemptive arrangement could reduce risk of sanctions arising from incorrect self certification and tax filing, as well as improve work morale for the dispatched employees.

As corporate taxpayers, thorough review of the local tax policies or consultation with a tax consultant is recommended for companies before conducting cross border transactions so as to fully understand and utilize tax relief policies that might be available to them, as well as their eligibility to tax credit claims. Companies which have intergroup transactions across different jurisdictions should properly structure and document their transfer pricing policy and keep sufficient and complete tax records along with supporting documents to substantiate their tax claims in preparation for potential challenges from the tax authorities.

Transfer pricing documentation including Country-by-Country Reporting (“CbC Report”)

Once the Amendment Bill No.6 pass through the Legislative Council, Hong Kong will officially adopt the three-tiered standardized approach to transfer pricing documentation developed by the OECD, which includes the Master File, the Local File and the CbC Report.

It is expected that for the fiscal years starting on or after 1st April, 2018, Hong Kong companies would be required to file the Master File and the Local File within six months after the end of their accounting period. Compared with the relevant Consultation Paper, the threshold of exemption for the filing of the Master File and the Local File is lower. According to the Amendment Bill No.6, exemption for the filing of the Master File and the Local File would be available to companies which satisfy any two of the following three conditions:- total annual revenue not exceeding HKD200 million; total assets not exceeding HKD200 million; and no more than 100 employees.

Notwithstanding the above, if the total amount of a particular category of related party transactions does not exceed the following threshold, that category of transactions would not be required to be covered in the Local File.

1) Transfer of properties (other than financial assets and intangibles): HKD220 million;
2) Transaction of financial assets: HKD110 million;
3) Transfer of intangibles: HKD110 million; and
4) Any other transaction (e.g. service income and royalty income): HKD44 million

If the corresponding amounts of all categories of transactions do not meet with the thresholds as specified above, both the Local File and the Master File would be exempted.

Meanwhile, if the annual consolidated group revenue of the multinational enterprises (“NME”) is less than HKD6.8 billion, the MNE group would not be required to file the CbC report. Otherwise, the MNE Group’s ultimate parent entity with its tax residency in Hong Kong, or a Hong Kong entity whose ultimate parent entity is not required to file a CbC report in its jurisdiction of tax residence or its jurisdiction has no exchange arrangement in effect with Hong Kong, is required to file a CbC return together with the CbC report in Hong Kong for each accounting period beginning on or after 1st January, 2018 within 12 months from the last day of their fiscal year.

Multinational corporations or any companies with cross border activities should review their existing business to evaluate whether they would be subject to the new regulations, and continue to monitor the development of the situation.

Should you need further explanation on the above matters, please kindly contact us at (852) 3929-4800 to seek our professional advice.

Contact us:

For more information, please contact:

Edmond Poon
CEO, Tax Director
Tel: (852) 3929 4912
Email: edmond.poon@aoba.com.hk

About Aoba & Hopkins Group:

The Aoba & Hopkins Group consists of CPA firms and full service consulting firms located in Hong Kong, Guangzhou and Beijing that have been providing quality and efficient professional services to our valued clients aboard and at home since 1989.

Our Website: www.aoba.com.hk

Hong Kong: 3/F, Sun Hung Kai Centre, 30 Harbour Road, Wanchai, Hong Kong
Tel: (852) 2802 1092 Fax: (852) 2850 7151

Guangzhou: Unit B, 12/F, Goldsun Building, No.109 Tiyuxi Road, Tianhe District, Guangzhou, China
Tel: (86) 20-3878 5798 Fax: (86) 20-3878 5337

Beijing: Room 605, 6/F, East Ocean Centre, No. 24 Jian Guo Men Wai Street, Chao Yang District, Beijing, China
Tel: (86) 10-6522 8158 Fax: (86) 10-6512 7168

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