

Two-tiered Profits Tax Rates Regime to be Implemented from the Year of Assessment 2018/19

On 29th March 2018, the Inland Revenue (Amendment) (No.3) Ordinance 2018 (“the Ordinance”) was gazetted, thereby the two-tiered profits tax rates regime announced in the 2017 Policy Address was formally enacted, with the aim to reduce tax burden on Hong Kong taxpayers, especially for small and medium enterprises, and to increase Hong Kong’s competitiveness in attracting foreign investments.

Two-tiered profits tax rates

For any year of assessment commencing on or after 1st April 2018, the tax rates for the first HKD2,000,000 of assessable profits of both corporations and unincorporated businesses (i.e. partnerships and sole proprietorships) would be reduced by half, irrespective of the size of the entities. The applicable tax rates are as follows:-

Assessable Profits	Tax rates	
	Corporations	Unincorporated businesses
First HKD2,000,000	8.25%	7.5%
Over HKD2,000,000	16.5%	15%

Restrictive covenants

Only one entity among “connected entities” will be eligible

To prevent entities taking advantage of the two-tiered tax regime by excessively restructure their business or income splitting, the Ordinance provides that only one entity among “connected entities” could be nominated to benefit from the two-tiered progressive rates for a year of assessment.

An entity is a connected entity of another entity if-

- one of them has control over the other;
- both of them are under the control of the same entity; or
- in the case of the first entity being a natural person carrying on a sole proprietorship business – the other entity is the same person carrying on another sole proprietorship business.

For the definition of control, it provides that an entity (entity A) has control over another entity (entity B) if entity A, whether directly or indirectly through one or more interposed entity–

- owns or controls more than 50% in aggregate of the issued share capital of entity B;
- is entitled to exercise or control the exercise of more than 50% in aggregate of the voting rights in entity B;
- is entitled to more than 50% in aggregate of the capital or profits of entity B; or
- in the case of entity B being a trust – entity A is entitled to a vested interest in more than 50% of the capital of the property of the trust.

When determining the percentage in aggregated interest through interposed entities, the Ordinance provides that the percentage is arrived by multiplying the percentage representing the extent of the direct interest of entity A in the first interposed entity by the percentage of each interposed entity in the next in the series and by the percentage of the last interposed entity in entity B. For instance, if entity A holds 70% direct interest in entity X that holds 80% direct interest in entity B, then entity A is considered holding 56% (i.e. 70% multiply by 80%) indirect interest in aggregate of entity B.

No double benefits for existing half-rate tax regimes

A corporation that has made an election for preferential half-rate tax in respect of a portion of its assessable profits for carrying on business as a professional reinsurer, corporate treasury centre, aircraft lessor or leasing manager would not be eligible to elect for the two-tiered tax regime.

Moreover, interest, gain or profits derived from qualifying debt instruments that already enjoy half-rate tax would not be counted into the first HKD2,000,000 assessable profits and be taxed at half-rate tax again.

Transitional provisions relating to provisional profits tax for the year of assessment 2018/19

The two-tiered profits tax rates regime should take effect on the provisional profits for the year of assessment 2018/19. An entity that is likely to be chargeable to profits tax under the two-tiered tax rates regime but has been assessed on standard rate may apply for holding over the whole or part of the provisional tax until the entity is required to pay profits tax for the year.

For applying such hold over, written application must be made not later than the 28th day before the day by which the provisional profits tax is to be paid, or the 14th day after the date of the notice for payment of provisional profits tax, whichever is the later.

Plans of action

Companies with multiple connected entities in Hong Kong should review their business structures and consider which Hong Kong entity should be elected to be assessed on the two-tiered profits tax rates regime so as to bring the most benefit to the group. However, please be mindful that the Ordinance contains a provision that “the selection, once made, is irrevocable”. Currently, it is unclear whether it applies only to the specific year of assessment during which the election was made or implies that the entity once nominated could not be changed to other connected entities in the following years. It is expected that there will be further clarification on the irrevocability of election and the detail election procedures after the Inland Revenue Department issues implementation guideline on the matter. In the meantime, companies should consider carefully which entity to be elected.

For a company that is eligible and likely to elect for the two-tiered tax rates but has already been assessed to provisional tax on standard rate for the year of assessment 2018/19 should consult with tax advisors whether application for holding over part of the tax assessed would be applicable.

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

Contact us:

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