

2022/23 Hong Kong Budget Commentary

Overview

On 23rd February, 2022, Mr. Paul M Chan, the Financial Secretary of Hong Kong, delivered his sixth budget speech to the Legislative Council.

Since the new Omicron COVID-19 variant outbreak, countries have enforced lockdown restriction, which put further weigh on the global economic growth. Nevertheless, Hong Kong's economic recovery should attain solid growth in the fourth quarter of 2021, leading to the GDP real growth reaching 6.4% in 2021 as a whole. However, the real GDP will still be around 2% below the pre-pandemic level in 2018.

Considering that the impact of new virus wave was contained in the year 2021 by the anti-epidemic measures and the vaccination coverage, the adjusted unemployment rate declined from 7% in 2020 to 3.9% in the fourth quarter of 2021. The extent of further improvement in labour market conditions will hinge on the pace of the economic recovery. In particular, the unemployment rates of the consumption- and tourism-related sectors reduced noticeably in recent months, so did the same in many other sectors such as the arts, entertainment and recreation sector, the construction sector, and postal and courier activities. The underlying consumer price inflation declined from 1.3% for 2020 to averaging 0.6% in 2021. In view of the latest Omicron variant, the global and Hong Kong's near term economic prospects remain uncertain.

The budget surplus of 2021/22 is HKD18.9 billion, which is HKD120.5 billion higher than the original deficit projection of HKD101.6 billion. To revitalise Hong Kong's economy from COVID-19 and build resilience in city's long-term competitiveness, the Government will adopt financial measures to relieve people's burden and stabilize the economy in the future. As such, the budget has proposed the following relief measures:-

Highlights

Proposed fiscal/ tax measures	
1	Reduce profits tax, salaries tax and tax under personal assessment for 2021/22 by 100 percent, subject to a ceiling of HKD10,000
2	Waive rates for residential properties for 2022/23, subject to a ceiling of HKD1,500 per quarter in first two quarters and HKD1,000 per quarter in remaining two quarters
3	Waive rates for non-residential properties for 2022/23, subject to a ceiling of HKD5,000 per quarter in the first two quarters and HKD2,000 per quarter in the remaining two quarters
4	Waive the business registration fees for 2022/23
5	Issue HKD10,000 electronic consumption vouchers in instalments to each eligible Hong Kong permanent resident and new arrival aged 18 or above
6	Extend the special 100% loan guarantee for individuals with a ceiling of HKD100,000 with maximum repayment period of 10 years
7	Allow tax deduction for residential rental expenses under salaries tax to who are not owners of domestic properties subject to a deduction ceiling of HKD100,000 per year starting from 2022/23
8	Rental Enforcement Moratorium to prohibit landlords from terminating the tenancy of or not providing services to tenants of specified sectors for failing to settle rents on schedule valid for three months and may be extended for another three months

Policies for long-term development	
1	Supporting anti-epidemic efforts with totaling HKD67.5 billion, including HKD22 billion for strengthening testing work and additional support for the Hospital Authority
2	Allocate HKD10 billion to the Hong Kong Growth Portfolio under the Future Fund to focus on investment in technology enterprises and projects and investment opportunities in the Guangdong-Hong Kong-Macao Greater Bay Area
3	Examine the revision of the listing requirements to meet the fundraising needs of technology enterprises

Introduction to profits tax treatment of court-free amalgamation of Hong Kong companies

With effect from 11th June 2021, the Inland Revenue (Amendment) (Miscellaneous Provisions) Ordinance 2021 (“the Amendment”) was enacted to codify a special tax treatment of court-free amalgamation of Hong Kong companies in a qualifying amalgamation (i.e. one is a wholly owned subsidiary of the other or both are wholly owned subsidiaries of a body corporate) under the Companies Ordinance.

Brief introduction to Part 6C of and Schedule 17J to the Inland Revenue Ordinance (“IRO”)

Subject to meeting certain conditions, the special tax treatment provided in the Amendment, Part 6C of and Schedule 17J to the IRO, will generally allow for tax treatment of the amalgamated company (i.e. the surviving company) as if it is the succession of and the same person as the amalgamating company (i.e. the company whose shares are cancelled) in a qualifying amalgamation without sale of assets.

To elect for the special tax treatment that covers the succession of business, capital assets, trading stock, allowances in respect of commercial/industrial buildings or structures and machinery or plant, recognized retirement scheme, utilization of pre-amalgamation losses, etc., the amalgamated company should inform the Inland Revenue Department (“IRD”) in writing within one month from the date of the amalgamation. In this regard, the amalgamating company is treated as having ceased to carry on its business on the day immediately before the amalgamation; while the amalgamated company should undertake all obligations, assume all liabilities and be entitled to all rights, powers and privileges of the amalgamating companies under the IRO. Hence, the amalgamated company is obligated to fulfill the tax returns filing requirements of the amalgamating companies for their year of cessation.

When considering for the election of special tax treatment, keen attention should be paid to the anti-tax avoidance conditions incorporated in the Amendment, specially concerning the set-off of pre-amalgamation tax losses of the amalgamating company and the amalgamated company.

Tax treatment for pre-amalgamation losses

In order to prevent the acquisition of loss-making companies and the transfer of losses between group companies to reduce tax liabilities, restraints and conditions are put in place for the set-off of unutilized pre-amalgamation tax losses of the amalgamating company and the amalgamated company against the assessable profits of the amalgamated company under the special tax treatment. Firstly, it should be proved to the satisfaction of the Commissioner that the main objective of the court-free amalgamation is not for the purpose of tax avoidance or obtaining tax benefits. Further condition tests for utilizing the pre-amalgamation losses of the amalgamating and amalgamated companies are set out below:

Set-off of pre-amalgamation losses of amalgamating company

- 1) Same trade test: tax losses brought forward from the amalgamating company can only be used to set off against the profits of the amalgamated company derived from the identical trade or business succeeded from the amalgamating company;
- 2) Post entry test: the losses were incurred after the amalgamating company and the amalgamated company entered into a qualifying relationship (i.e. one is a wholly owned subsidiary of the other or both are wholly owned subsidiaries of a body corporate); and
- 3) Commercial reason test: there are good commercial reasons for carrying out the amalgamation.

Set-off of pre-amalgamation losses of amalgamated company

- 1) Trade continuation test: the amalgamated company has continued to carry on a trade or business since the qualifying loss was incurred up to the date of amalgamation;
- 2) Financial resources test: the amalgamated company has adequate financial resources (excluding intra-group loans) immediately before the amalgamation to purchase the trade or business of the amalgamating company; and
- 3) Post entry test and commercial reason test: same as above.

Unless the above tests are fulfilled, the pre-amalgamation losses of the amalgamated company can only be used to set-off against the profits derived from its original business.

Stamp duty

From the view of the government, the succession of assets of the amalgamating company by the amalgamated company is by operation of law. As such, no stamp duty should arise as no instrument is to be executed for the succession of Hong Kong stocks or immovable properties under court-free amalgamation.

Conclusion

As the tax effect for the application of the court-free amalgamation of Hong Kong companies may be significant, the companies should carefully analysis the potential tax impact and evaluate whether the conditions specified in the Amendment can be fulfilled before making the election for the special tax treatment, which, once made, is irrevocable.

According to the Bill Committee before the passage of the Amendment, the IRD will consider all relevant facts and circumstances when considering whether the conditions imposed by the Amendment can be fulfilled, such as the circumstances, the non-tax purpose and the intended result of the amalgamation, whether there are alternative ways to achieve the non-tax purpose, the business and operation model before and after the amalgamation, etc. As such consideration involves subjective judgement, which may give rise to many uncertainties, more guidance may be given by the IRD by issuing the Departmental Interpretation and Practice Notes with examples later on.

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