

Two-tier Tax Systems for SMEs and New Incentives for Innovation and Technology Sector

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INTRODUCTION

The Chief Executive, Ms Carrie Lam, presented her maiden policy address today. Ms Lam reported that the inflation rate has dropped for 6 consecutive years and the latest unemployment rate is dropping to 3.1%, the lowest level in recent two decades. She estimated the overall GDP growth rate of Hong Kong will go higher than 3.5%, better than the annual average of 2.9% over the past decade.



Small and medium-sized enterprises (“SMEs”)¹ are the backbone of the Hong Kong economy. For the economic growth of Hong Kong and to promote the innovation and technology development in Hong Kong, Ms Lam announced two new tax measures in her agenda.

NEW TAX MEASURES

(1) Two-tier profits tax system

A two-tier profits tax system will be introduced in 2018 whereby a concessionary rate at 50% of the normal profits tax rate be applied to the first HK\$2 million annual taxable profits of the taxpayer. To ensure that the tax benefits will target SMEs, only one enterprise nominated by each business group is eligible for the lower tax rate.

The government indicated that the amendment bill to facilitate the launch of the new two-tier profits tax system is expected to be tabled at the Legislative Council by year’s end.

(2) Super deduction for R&D expenditure

To encourage research and development (“R&D”) investment by the enterprises, Ms Lam proposed that the first HK\$2 million eligible R&D expenditure will enjoy a 300% tax deduction with the remainder at 200%. It is targeted to double the R&D expenditure as a percentage of the GDP from the current 0.73% to 1.5% within 5 years. Comparing to the R&D to GDP ratio of Hong Kong’s major competitor, Singapore, which was 2.2% in 2014 (*per 2014 data published by OECD in January 2017*), Hong Kong has a long way to go.

Ms Lam further mentioned that she would like to increase the total number of comprehensive double taxation agreements (“CDTA”) to 50 in the next few years. Hong Kong has presently entered into 38 CDTA.

We welcome Ms Lam’s proposal to help SMEs and to encourage spending on R&D, though we hope that more tax measures will be introduced, e.g. tax deduction for the purchase of regulated health insurance products, which has not been addressed. The proposed tax measures are not final and will be reviewed by the Legislative Council.

¹ At present, under the definition adopted by the SAR Government, a SME in Hong Kong is:

- Manufacturing enterprise
 - Employees* in Hong Kong less than 100
- Non-manufacturing enterprise
 - Employees* in Hong Kong less than 50

**“Employees” include proprietors/partners/shareholders actively engaged in the enterprise’s business and all salaried employees, including employees under full-time or part-time, permanent or temporary employment, at the time of application.*



The content of this newsletter is only for general guidance on matters of interest and is not meant to be comprehensive. The application and impact of laws can vary widely based on the specific facts involved. Readers are advised to consult their tax advisors before making any business decisions.

CONTACTS

Mazars

Tax department

HONG KONG

42nd Floor, Central
Plaza, 18 Harbour Road
Wanchai, Hong Kong
Tel: (+ 852) 2909 5555

Michael To

Managing Director
Tel: (+852) 2909 5680
Email: michael.to@mazars.hk

Anthony Tam

Executive Partner
Tel: (+852) 2909 5604
Email: anthony.tam@mazars.hk

Alexandra Hui

Tax Partner
Tel: (+852) 2909 5678
Email: alexandra.hui@mazars.hk

More information on
www.mazars.hk