

BUDGET SPECIAL REPORT 2011/12

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Prepared by Mazars Tax Services Limited

In delivering his fourth budget speech today, the Financial Secretary Mr. John Tsang remarked that our economy has fully recovered after we have been fighting back against the financial tsunami for the past three years. According to the figures released by the Financial Secretary in the budget speech for 2011-12 today, better than expected rebound of the economy helped boost Government revenues in 2010-11.

This Budget News summarized the budget proposals, which are not final and will be reviewed by the Legislative Council shortly. Some of the proposals may be amended or may not be enacted at all.

ECONOMIC PERFORMANCE AND OUTLOOK

The Financial Secretary said that the Hong Kong economy in 2010 had a full recovery at a faster pace than expected. For 2010, GDP grew by 6.8% in real terms. Hong Kong's exports of goods soared by 17.3% in real terms while private consumption spending grew by 5.8% and the overall investment spending grew by 8.1%. As the job market improved significantly in the past year, the unemployment rate dropped from its peak in mid-2009 by 1.7% to 3.8% recently. The Financial Secretary expected that there will be limited room for further significant decline in unemployment rate as it has already fallen back to a relatively low level and the implementation of statutory minimum wage in May this year may impact the unemployment rate.

The Financial Secretary said that the economy has a solid growth for 2010-11 and at the same time, inflationary pressure has gradually built up in Hong Kong because of a soft US dollar and rising food and commodity prices around the world. The average inflation rate for 2010 as measured by the Composite Consumer Price Index was 2.4%. The Financial Secretary forecast inflation of 4.5% with GDP growth of 4% to 5% for 2011.

For 2010-11, the Financial Secretary revised the estimated Government revenue to HK\$374.8 billion and Government expenditure to HK\$303.5 billion, resulting in a consolidated surplus of HK\$71.3 billion compared with the estimated deficit of HK\$25.2 billion in last year's budget speech. The revenue was mainly contributed by tax revenue from profits tax and salaries tax of HK\$140.5 billion, stamp duty from the stock and property markets of HK\$51 billion and land revenues of HK\$62 billion. The revenue from all the three sources is higher than the original estimates. The revenue from stamp duty and land sales was 70% and 82% higher than original estimates.

By 31 March 2011, our fiscal reserves are expected to reach HK\$591.6 billion, equivalent to 23 months of Government expenditure, or 34% of GDP.

For 2011-12, total Government revenue is estimated to reach HK\$375 billion and total Government spending is estimated to reach HK\$371.1 billion, resulting in a consolidated surplus of HK\$3.9 billion.

In the medium term, average growth rate is forecast at 4% in real terms for the period 2012-15, with underlying inflation averaging 3.5%. Fiscal reserves are estimated to reach approximately HK\$697.7 billion by end-March 2016, representing about 30% of GDP and equivalent to 20 months of Government expenditure.

In his budget speech, the Financial Secretary proposed to increase spending on areas related to people's livelihood, to alleviate the inflationary pressure of the people, to reduce the risk of asset-price bubbles, and to use public resources to invest in the future.

2011/2012 BUDGET HIGHLIGHTS

Alleviation of Inflationary Pressure

While the economy had a strong growth last year, Hong Kong is facing an increased risk of inflation. The inflation for this year is expected to be 4.5%. The Financial Secretary proposed multi-billion dollar package of relief measures to ease the impact of inflation:

Relief Measures

- To waive rates for 2011-12 capped at HK\$1,500 per quarter for each rateable property.
- To provide electricity subsidy of HK\$1,800 to each residential electricity account.
- To pay two month's rent for public housing tenants.
- To provide one extra month of Comprehensive Social Security Assistance ("CSSA") payment, Old Age Allowance and Disability Allowance.
- To increase basic and additional child allowance by 20% (please refer to attached tax facts for details).
- To increase dependent parent/grandparent allowances and deduction ceiling for residential care expenses by 20% (please refer to attached tax facts for details).
- To make a one-off injection of HK\$6,000 into MPF accounts.
- To reserve an additional HK\$100 million for making injection to the short-term food assistance services.

iBond

In addition to the above relief measures, the Financial Secretary announced plans to issue HK\$5 billion to HK\$10 billion worth of inflation-linked retail bonds to provide Hong Kong residents with another investment option for coping with inflation while promoting the development of the local retail bond market. The preliminary plan is to issue iBond with a maturity of three years with interest payable once every six months at a rate linked to the inflation of the last half-year period. The Hong Kong Monetary Authority is working out the implementation details and sales arrangements, with an aim to launching the bonds in six months.

Stabilize the Property Market

The Financial Secretary indicated that the most effective medium to long term solution to stabilize the property market was ensuring a steady and adequate land supply. The following new measures were proposed to increase the land supply:

- Total housing land available in the coming year will provide a total of 30,000 to 40,000 private residential flats, far exceeding the original target of an annual average of 20,000 flats.
- Identify more suitable sites for the My Home Purchase Plan.
- Allocate about HK\$300 million to explore the feasibility of reclamation on an appropriate scale outside Victoria Harbour and rock cavern development to increase the supply of land.

Invest in the Future

The Financial Secretary did not propose to reduce the profits tax rate or introduce tax incentives to attract foreign investment. Instead, the Financial Secretary proposed to invest in Hong Kong's future economic development in the following ways to maintain Hong Kong's competitiveness:

- Increase the supply of Grade A office premises and develop high-grade office clusters through land use planning, urban design, area improvement and the provision of better transport networks.
- Invest in transport infrastructure projects and optimize multimodal transport services to promote the development of air, sea and land transport and logistics.
- Streamline the listing process for overseas companies, shorten the timetable and lower the IPO costs.
- Strengthen co-operation with Guangdong Province, Macao, Taiwan and other regions in various aspects to sharpen Hong Kong's competitive edge in the global market.
- Continue to develop Hong Kong's four pillar industries: trade and logistics, professional services, tourism and financial services.
- Roll out support measures for six identified industries: medical services, testing and certification services, education services, environmental industries, cultural and creative industries and innovation and technology, promote wine trading and explore new opportunities in emerging markets to promote diversification of Hong Kong's economy.
- Support SMEs by increasing the total guarantee commitment under the SME Loan Guarantee Scheme to HK\$30 billion.

Improve Livelihood

The Financial Secretary proposed new measures in education, health care, elderly services and sports development to improve people's livelihood. He announced that around 56% of the recurrent expenditure will be used in education, health and social welfare. The recurrent expenditure in education, health and social welfare for 2011/2012 will be increased by HK\$3 billion, HK\$3.2 billion and HK\$4.2 billion to HK\$54.5 billion, HK\$40 billion and HK\$42.2 billion respectively.

Other Measures

To protect public health, the Financial Secretary proposed to increase tobacco duty by HK\$0.5 to HK\$1.706, or 41.5% per stick of cigarette. Duties on other tobacco products will be increased by the same rate.

The Financial Secretary also proposed to raise the First Registration Tax on private cars by 15% in order to contain the growth of private cars.

TAX FACTS

PROFITS TAX

The profits tax rates for corporations and unincorporated businesses will remain at 16.5% and 15% respectively in 2011/12. The profits tax rates are summarized in Table 1 below.

Table 1: Profits Tax Rates	
	<u>2011/12 & 2010/11</u>
	<u>%</u>
Corporations	16.5
Others	15.0

SALARIES TAX AND PERSONAL ASSESSEMENT

Tax Rates & Allowances

Tax rates and tax bands for salaries tax and personal assessment all remain exchange and are summarized in Table 2:

Table 2: Salaries / Personal Assessment Tax Rates	
<u>Progressive Rates</u>	<u>2011/12 & 2010/11</u>
<u>Income net of</u>	<u>Rate</u>
<u>allowances</u>	<u>%</u>
HK\$	
Under 40,001	2
40,001–80,000	7
80,001–120,000	12
Over 120,000	17
Standard rate	15

The Financial Secretary proposed to increase the basic and additional dependent parent/grandparent allowances, deduction limit residential care, and child allowance and the additional one-off child allowance in the year of birth by 20% deduction and allowances are summarized in Table 3:.

Table 3: Deductions / Allowances	<u>2011/12</u>	<u>2010/11</u>
	<u>HK\$</u>	<u>HK\$</u>
Deduction Limits		
Self-education	60,000	60,000
Home loan interest	100,000	100,000
Elderly residential care	72,000	60,000
Contribution to retirement Scheme	12,000	12,000
Allowances		
Personal		
• Basic	108,000	108,000
• Married person	216,000	216,000
• Single parent	108,000	108,000
Child		
1 st to 9 th		
• Year of birth	120,000	100,000
• Other years	60,000	50,000
Dependent parent / Grandparent		
• Basic		
- Aged 55 – 59	18,000	15,000
- Aged 60 or above	36,000	30,000
• Additional		
- Aged 55 – 59	18,000	15,000
- Aged 60 or above	36,000	30,000
Disabled dependant	60,000	60,000
Dependent brother/sister	30,000	30,000

The break-even points for 2011/12 where the progressive rates of tax will not apply for a single person or married person under separate assessment ("Single Person") and a married couple with up to two children will change due to the increase in child allowances. The break even points are shown in Table 4

Table 4: Break-Even Points			
<u>No. of children</u>	<u>Single Person</u>		
	HK\$		
	<u>2011/12</u>	<u>2010/11</u>	
None	1,518,000	1,518,000	
1	2,028,000	1,943,000	
2	2,538,000	2,368,000	
<u>No. of children</u>	<u>Married Couple</u>		
	HK\$		
	<u>2011/12</u>	<u>2010/11</u>	
None	2,436,000	2,436,000	
1	2,946,000	2,861,000	
2	3,456,000	3,286,000	
Income level for break-even points will be increased by HK\$510,000 for each additional one-off child allowance for new born child in 2011/12 (HK\$425,000 for 2010/11)			

PROPERTY TAX

Property tax rate will remain at 15%.

STAMP DUTY

Property transactions

Stamp duty on property transactions will remain unchanged. The threshold values for various stamp duty bands and duty rates are shown in Table 5.

Table 5: Stamp Duty on Property Transactions	
<u>HK\$Million</u>	<u>Rate</u> <u>2011/12 & 2010/11</u>
0-2	HK\$100
2-3	1.50%
3-4	2.25%
4-6	3.00%
6-20	3.75%
Over 20	4.25%

Special Stamp Duty

The Government proposed to produce Special Stamp Duty on residential property transactions on 19 November last year. The Bill was gazetted on 3 December 2010. Subject to the enactment of the new legislation, Special Stamp Duty (SSD), will impose on transactions of residential properties for all values if the property is acquired by vendor on or after 20 November 2010 and resold within 24 months after acquisition.

Table 6 : Special Stamp Duty on Residential Property

<u>Holding period (month)</u>	<u>Rate</u>
0-6	15%
6-12	10%
12- 24	5%

Stock transactions

Stamp duty on stock transactions will remain unchanged at 0.2%.

TOBACCO DUTY

To protect public health, the Financial Secretary proposed to increase the tobacco duty on cigarettes by HK\$0.5 to HK\$1.706 per stick and increase duties on other tobacco products by similar ratio.

PRIVATE CARS FIRST REGISTRATION TAX

To contain the growth of private cars, the Financial Secretary proposed to increase the First Registration Tax for private cars by about 15%.

GOVERNMENT DUTIES

Rates

To waive rates for 2011/12, subject to a ceiling of HK\$1,500 per quarter per rateable tenement.

Contacts

Hong Kong

42/F., Central Plaza,
18 Harbour Road,
Wanchai
Hong Kong

Tel : (852) 2909 5555

Email : info@mazars.com.hk

Fax : (852) 2810 0032

Website : www.mazars.com.hk