

# MAZARS 2013/2014 BUDGET PROPOSAL

*Hong Kong, 17 January 2013*

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## INTRODUCTION

In 2012, the deteriorating Eurozone sovereign debt crisis and the US fiscal cliff weakened the global economy. As a small open economy with linked exchange rate system, Hong Kong's economy had inevitably been affected. While external demand had decreased, Hong Kong's GDP growth rate managed to accelerate from 0.7% in the 1<sup>st</sup> quarter to 1.3% in the 3<sup>rd</sup> quarter of 2012. The 2012 12-month GDP is anticipated to grow by 1.3%, mainly contributed by domestic demand. Although such a growth rate may sound good compared with the global economy, it represents a big cut compared with a 7% growth rate in 2010 and 5% in 2011.

Hong Kong's economic outlook for 2013 remains challenging and will largely depend on the worldwide economic condition and the Mainland industrial profit performance.

Excessive liquidity echoed with low interest rate continues to boost the property market. Rising rental rates and costs of living add pressure on inflation. The Hong Kong people face rising prices in every aspect of living, such as food, daily consumables, housing, utilities, and transportation.

The Chief Executive has identified housing, environment - in particular, air pollution, - the elderly and livelihood as the focus of the 2013 policy address. Housing issue needs to be tackled by increasing land supply.

In this budget proposal, our recommendations cover three broad and important areas: Improving livelihood, sustaining and developing economic growth and improving environment.

# 1. IMPROVING LIVELIHOOD

## 1.1. Housing

Housing is a fundamental need of the general public. The overall flat prices have increased by 20% in the first 9 months of 2012 and by 107% since 2008. Property prices are rising beyond the affordability of the general public. Last October, the government took a new round of measures to tackle the overheated property market by imposing a 15% stamp duty on non-residents and corporate buyers in an attempt to make homes more affordable for local people. It has been more than 2 months now, the measures appear not making housing more affordable for local people. Consequently, when people cannot afford to buy their own homes, they will turn to the rental market and that will push up rentals. To help relieve the burden of renters, **Mazars proposes to expand the benefit of home loan interest deduction into home rental deduction.** Housing is a life-long need of the general public. Hence, **we recommend not imposing a limit on the duration of deduction claim.** For owners of properties used as their primary residence, on the same grounds, **Mazars proposes the government to extend deduction on home mortgage loan duration of 15 years to life-long.** The deduction of home loan interest / home rental deduction should be subject to the same deduction ceiling.

With increasing property prices, **Mazars proposes to increase the threshold values for stamp duty bands** in order to make transaction costs of purchasing non-luxury property affordable by the general public. **Stamp duty of HK\$ 100 should be applicable to property value below HK\$ 3,000,001.** Proposed threshold values for stamp duty bands are shown in Appendix I.

While the government has announced to grant more land for the “Hong Kong property for Hong Kong residents”, public housing plays an important role in our community as it provides more affordable housing to the eligible people. At the same time, they are also facing rising cost of living. To help this community, **Mazars proposes the government to continue to pay two months’ rent for public housing tenants.**

## 1.2. Address the community needs

Overall consumer prices rose by 3.7% in November compared to the same month in 2011. After netting out the effects of the government’s one-off relief measures, the year-on-year rate of increase in the composite CPI was 3.8% in November. It is anticipated that the inflation rate is 4% for 2012 and will rise to 4.3% in 2013. The projected rise is due to several factors including rising rental rates, increasing food prices and excessive liquidity in the global market. The government should take measures to relieve people’s pressure of rising cost of living. To provide more effective support for specific and vulnerable groups within the community, **Mazars proposes the government to take the following measures:**

- a) Increase personal and other allowances (for salaries tax and personal assessment) by 5%
- b) Widen the tax band from HK\$ 40,000 to HK\$ 50,000

Since January 2013, tariffs on electricity have increased. Electricity is a daily necessity for the general public. To assist families to cope with the increasing electricity price, **Mazars proposes the government to provide a HK\$ 2,000 subsidy on electricity expense per household.**

To help ease the burden of the community, **Mazars also proposes to continue to waive rates, capped at HK\$ 2,500 per quarter for each rateable property.**

### 1.3. Ageing population

Hong Kong has a rapidly ageing population. The government has announced the introduction of the Old Age Living Allowance as an additional financial assistance for the elderly who are in need of financial support. Meanwhile, the community is encouraged through savings, investment and insurance policies to prepare their individual retirement. The current MPF system was established to help the working population accumulate retirement savings. Since the average amount of savings vested from the mandatory contribution is inadequate to provide a stable retirement life, giving out tax incentives to encourage taxpayers to make more voluntary contribution is necessary. **Mazars proposes to allow tax deductions for employee's voluntary contribution to Recognised Occupational Retirement Schemes or MPF scheme.**

Pending the long-term health reform and funding arrangement, **Mazars proposes the government to allow tax deduction for contributions to private medical insurance policies** to encourage taxpayers to take out healthcare protection and move away from public healthcare.

**Mazars proposes that the amount of deduction for MPF contributions (including mandatory and voluntary contributions) together with the private medical insurance should not exceed 15% of the gross remuneration of a taxpayer.**

### 1.4. SMEs

As of September 2012, there were about 300,000 SMEs in Hong Kong. They accounted for over 98% of local enterprises and provided job opportunities to over 1.2 million people, i.e. about 47% of the total employment (excluding civil service). 2013 will be another tough year for businesses in particular SMEs. The impacts of the Eurozone sovereign debt crises and recovery of the US economy are uncertain. The SMEs are likely to be the hardest hit during the economic downturn. Operating costs have increased due to rising rentals coupled with the minimum wages. Since the global financial crisis in 2008, many SMEs have struggled to cope with reduced orders and increased credit defaults among overseas customers, resulting in cash flow problems. Many SMEs are struggling to survive. Furthermore, there is a number of SMEs having manufacturing operations in Mainland China. The current practices of the Inland Revenue Department deny all the deductions / depreciation allowances claimed on the plant and machinery used in the manufacturing operations in the Mainland. While they struggle for their survival, the denial of deduction / depreciation allowances has increased their operating costs and brought them into severe hardship.

To help our businesses navigate through the possibility of another round of global economic turmoil, **Mazars proposes the following measures:**

- a) **Introduce preferential corporate profits tax rate of 10% for SMEs whose assessable profits do not exceed HK\$ 2 million**
- b) **Allow tax losses to be carried back to offset against profits in previous year such that the business can get immediate tax refund**
- c) **Allow deduction of the costs incurred for plant and equipment used outside Hong Kong for producing Hong Kong taxable income**
- d) **Abolish annual business registration fee**

## 2. SUSTAINING AND DEVELOPING ECONOMIC GROWTH

In this proposal, we have suggested relief measures for our people and SMEs. We will also propose to implement incentives and measures to businesses to enhance Hong Kong's competitiveness.

### 2.1. Hong Kong's competitiveness

Though Hong Kong retains a relatively simple, and low rate tax system, its competitiveness has been eroded by neighboring jurisdictions which have sought to attract more business through changes in their tax regimes. Some of them have further offered tax incentives to compete for particular kinds of business investments.

Hong Kong's corporate tax rate has been in the range of 16% to 17.5% for over 10 years whilst it was the

trend of many jurisdictions in the region to reduce their corporate tax rates<sup>1</sup>. For example, Singapore has reduced its corporate tax rate from 25.5% in 2001 to 17% in 2010. Taiwan has substantially lowered its corporate tax rate from 25% in 2001 to 17% in 2010. The Philippines has reduced its corporate tax rate from 35% in 2006 to 30% in 2009. Meanwhile, corporate tax rate in Thailand has been reduced in phases to 20% in 2013.

To secure Hong Kong's long term, competitive position, **Mazars proposes that the government should reduce the corporate profits tax rate from 16.5% to 15 % as the first step to enhance the tax competitiveness of Hong Kong.**

### 2.2. Regional headquarters

Hong Kong is one of the most investor friendly jurisdictions in Asia and has been a favorite location as a hub for regional headquarters. Recently, Hong Kong's advantage has been undermined by the low corporate rates and tax incentives offered by the neighboring tax jurisdictions: Malaysia, Singapore, Shanghai and Thailand all provide tax incentives for operational regional headquarters.

In order to maintain Hong Kong's competitiveness and encourage more international companies to be based in Hong Kong, **Mazars proposes that the government should review the corporate tax system to address the needs for tax incentives and to offer concessionary tax rate of 10% to multinational companies using Hong Kong as their regional headquarters.**

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<sup>1</sup> Appendix II is a table showing the corporate tax rates of neighboring jurisdictions for the past 4 years.

### 2.3. Interest deduction

Under the prevailing Hong Kong tax regulations, tax deduction is not allowed for interest payments made to overseas associates because the recipients are not subject to Hong Kong tax. It has placed Hong Kong in a less advantageous position from a tax perspective.

To align with the international tax practice and to further strengthen its role as a preferred business and trading hub in Asia where international companies would set up their regional headquarters in, **Mazars proposes to impose a withholding tax on interest payments made by Hong Kong companies to overseas associates. With the proposed changes, the interest payments will satisfy the conditions for tax deduction since the recipients will be subject to tax on the interest income.** The measures will encourage international companies to establish their treasury functions in Hong Kong and use Hong Kong as their “cash pooling hub” so as to boost up Hong Kong’s position as an international financial centre.

### 2.4. Research and development expenses

While taxpayers are allowed tax deduction on capital expenditure incurred to purchase IP rights in copyrights, patents, know-how, registered trademarks and registered designs, **Mazars proposes a further tax deduction on R&D, i.e. “super tax deduction” of 200% expenditure incurred on R&D** so as to encourage Hong Kong businesses to be more innovative and technologically advanced.

### 2.5. Group loss relief

Many businesses operate in the form of group of companies for diversity of risks and operations and for commercial reasons. Our neighboring tax jurisdictions such as Japan, Malaysia and Singapore provide group loss relief whereby a company with a loss can transfer the loss to another company in the same group that has profits, thus, bringing the overall tax burden of the group into line with the net taxable profits of the group.

In order to enhance Hong Kong’s competitiveness and encourage international companies to set up companies in Hong Kong, **Mazars proposes to introduce a form of group loss relief in Hong Kong.**

## 3. IMPROVING AIR QUALITY

Air quality is an area that the Chief Executive has identified to put in resources to tackle the issues. Air pollution index has increased continuously. Road transport is a major source of pollution in Hong Kong. The government has previously launched incentive schemes to encourage vehicle owners to replace their pre-Euro, Euro I and Euro II diesel commercial vehicles with new commercial vehicles but the participation rate is low. There is an urging need to address problems of air pollution. Mazars understands that the government will ban high-polluting vehicles and offer subsidies to replace diesel-powered buses and trucks. On top of the above measures, **Mazars proposes to provide 200% tax deduction to encourage vehicle owners to replace their air-polluting commercial vehicles including taxis and light buses with environmental friendly vehicles.**

## Appendix I - Proposed Threshold Values for Stamp Duty Bands for Transfer of Property

Property value (HK\$ million)	Proposed Rate
Not exceeding 3	HK\$100
3 - 5	1.50%
5 - 7	2.25%
7 - 9	3.00%
9 - 20	3.75%
Over 20	4.25%

## Appendix II - Corporate Tax Rate in Hong Kong and Neighboring Tax Jurisdictions

	2009	2010	2011	2012
China	25%	25%	25%	25%
Hong Kong	16.5%	16.5%	16.5%	16.5%
Indonesia	28%	25%	25%	25%
Japan	42%	40%	40%	38%
Malaysia	25%	25%	25%	25%
Philippines	30%	30%	30%	30%
Singapore	17%	17%	17%	17%
South Korea	27.5%	24.2%	24.2%	22%
Taiwan	25%	17%	17%	17%
Thailand (a)	30%	30%	30%	23%
Vietnam	25%	25%	25%	25%

- (a) Thailand has reduced its corporate income tax rate to 20% for the two accounting periods starting from 1 January 2013.

## About Mazars

*Mazars is an international, integrated and independent organisation, specialising in audit, accounting, tax and advisory services. We rely on the skills of more than 13,000 professionals in the 69 countries which make up our integrated partnership.*

*In Asia-Pacific, Mazars has 26 offices in 14 countries with over 2,200 highly skilled and dedicated professionals, including more than 60 partners (international and local). Mazars has a wide range and multi sector clients consisting of large international groups, large local companies as well as bilateral and multilateral aid agencies.*

*In China, Mazars has 600 highly-qualified professionals based in Beijing, Guangzhou, Hong Kong and Shanghai. They are fully committed to serving the growing and diversified needs of both Chinese companies and international firms.*

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