

Bills Committee on Inland Revenue (Amendment) (No. 7) Bill 2017

Government's Responses to Written Submissions received by the Bills Committee

Purpose

This note sets out the Government's response to the views and concerns expressed in the four written submissions received by the Bills Committee from the Chinese Manufacturers' Association of Hong Kong, the Society of Chinese Accountants & Auditors ("SCAA"), the Liberal Party ("LP") and an organisation which wishes to remain anonymous ("anonymous party").

A. Policy Approach

2. We are pleased to note that the four organisations all support the proposed two-tiered profits tax rates regime. They generally believe that the initiative will help reduce the tax burden on enterprises, especially those on small and medium enterprises ("SMEs"). We thank for their support in this regard.

B. Threshold for applying the lower rate / exempting profits tax

3. The anonymous party suggested that in future, the Government may consider raising the threshold for applying the lower rate from \$2 million to \$3 million and exempting enterprises with assessable profits of less than \$700,000 from profits tax.

4. In response to the suggestion of raising the threshold from \$2 million to \$3 million for applying the lower rate, we would like to point out that the two-tiered profits tax rates regime was first proposed in the Chief Executive's Election Manifesto with the objective of reducing the tax burden on enterprises, especially small, medium and startup businesses. A concrete proposal was announced in the 2017 Policy

Address delivered by the Chief Executive in October 2017.

5. In 2015-16, about 111 900 enterprises in Hong Kong (comprising 82 500 corporations and 29 400 unincorporated businesses (“UBs”)) had assessable profits of \$2 million or below, and they contributed about 4% of the total profits tax of \$140 billion. 96% of the profits tax was contributed by some 23 900 enterprises (comprising 21 300 corporations and 2 600 UBs) with assessable profits above \$2 million.

6. As it can be seen from above, 82.4% (or 111 900) enterprises among all taxpaying enterprises (135 800) had assessable profits of \$2 million or below, and many of these enterprises are believed to be small, medium and startup businesses. Therefore, it is reasonable to set the threshold for the lower tax rate at \$2 million to focus the tax benefits of the two-tiered profits tax rates regime on the intended targets. It is worthy to note that the profits tax rate of the first \$2 million assessable profits has reduced from 10% set out in the Chief Executive’s Election Manifesto to 8.25% as announced in the 2017 Policy Address.

7. As for the suggestion of exempting enterprises with assessable profits of less than \$700,000 from profits tax, it will further narrow our tax base when only some 135 800 enterprises in Hong Kong paid profits tax in 2015-16. As a matter of fact, enterprises with assessable profits of less than \$700,000 can already benefit from the proposed two-tiered profits tax rates regime in future.

C. Restriction on connected entities

8. SCAA expressed that the proposed restriction on connected entities may create unwarranted conflicts among partners or shareholders of entities that have segregation(s) of business(es) for genuine reasons. As such, SCAA recommended that the lower tax rate be applicable to (a) all connected entities that do not have the same, or substantially similar, businesses; and (b) up to five connected entities that have the same, or substantially similar, businesses provided that there are differences in the shareholdings.

9. In order to ensure that the tax benefits will target at SMEs, we consider it necessary to restrict the application of the two-tiered rates to only one enterprise nominated among connected entities. If the proposed restriction were removed, a vast number of entities within a multinational group or listed company would be able to benefit from the proposed regime, given that conglomerates usually carry on different businesses via different vehicles. This would undermine our policy objective of targeting the tax benefits at SMEs.

10. Besides, there must be a clear dividing line for defining which entities are connected. To this end, we propose to adopt 50% as the dividing line. An entity would have control over the other if it controls more than 50% of the other's interest or profits. Thus, the majority shareholder who has the dominant control of his connected entities can determine which of them can elect the two-tiered rates. As the threshold is clear and objective, it should help minimise disputes among shareholders.

D. Profits tax rate

11. The LP suggested that the Government should reduce the upper corporate profits tax rate from 16.5% to 15% and correspondingly adjust the tax rate at the lower tier.

12. Hong Kong's corporate tax rate of 16.5% is amongst the lowest in the world. Nonetheless, given the international trend to reduce corporate tax rates in order to attract more foreign businesses, we have proposed to introduce the two-tiered profits tax rates regime to reduce the tax burden on enterprises, especially SMEs and startup enterprises, thereby fostering a favourable business environment and enhancing Hong Kong's competitiveness.

13. After introducing the two-tiered profits tax rates regime, we have no plan at present to reduce our upper corporate profits tax rate across the board. We will however continue to keep a close eye on the evolution of tax policy of other developed economies.

Financial Services and the Treasury Bureau
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