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Newsletter Hong Kong

Hong Kong introduces two-tiered profits tax rate

The Inland Revenue (Amendment) (No. 7) Bill 2017 (the “Amendment Bill”) was gazetted on 29 December 2017 to introduce the two-tiered profits tax rates regime announced in the 2017 Policy Address. This two-tiered profits tax rates regime was introduced by the Hong Kong government with an aim to maintain a competitive taxation system to promote economic development while maintaining a simple and low tax regime.

1. Two-tiered Profits Tax regime

The two-tiered profits tax regime will be applicable to both corporations and unincorporated businesses commencing from the year of assessment 2018/19 (i.e., on or after 1 April 2018).

For corporations, the profits tax rate for the first \$2 million of assessable profits of corporations will be lowered to 8.25%, whilst the remaining profits will continue to be taxed at the existing 16.5% tax rate. For unincorporated businesses which are mostly partnerships and sole proprietorships, the profits tax rate for the first \$2 million of assessable profits of corporations will be lowered to 7.5% whilst the remaining profits will continue to be taxed at the existing 15% tax rate.

The applicable tax rates are summarized as follows:

Assessable profits	Tax rate	
	Corporations	Unincorporated business
First HK\$2 million	8.25%	7.5%
Over HK\$2 million	16.5%	15%

Under the two-tiered profits tax rates regime, a tax-paying corporation or unincorporated business may save up to \$165,000 and \$150,000 each year respectively.

2. Only one entity among connected entities will be eligible for the two-tiered profits tax rates

In order for the legislative proposal to primarily benefit SMEs and startups, and also to prevent income-splitting, the Bill contains restrictive provisions prescribing that where at the end of the basis period of an entity for a year of assessment, it has one or more other connected entities, then the “connected entities” concerned can only elect one of them to be eligible for the two-tiered profits tax rates regime for the year of assessment.

An entity is considered as a connected entity of another entity if:

- a) one of them has control over the other¹;
- b) both of them are under the control of the same entity;
- c) in the case the first entity being a natural person carrying on a sole proprietorship business, the other entity is the same person carrying on another sole proprietorship business.

3. Avoiding double benefits

In order to avoid double benefits for taxpayers, the Bill contains a provision that the following enterprises shall be excluded from the two-tiered profits tax regime:

- a) enterprises electing the preferential half-rate tax regimes (e.g., professional reinsurance companies, captive insurance companies, corporate treasury centres and aircraft leasing companies); and
- b) the assessable profits for sums received by or accrued to holders of qualifying debt instruments as interest, gains or profits should already be taxed at half the rate (i.e., 7.5% or 8.25%, as the case may be).

4. Profits Tax Return - Transitional provisions

The Amendment Bill provides for transitional provisions in relation to the charging of provisional profits tax for the year of assessment commencing on or after 1 April 2018. The IRD has, therefore, updated the profits tax returns (BIR51 and BIR52) for the year of assessment 2017/18 and included the box 2.3 for taxpayer to opt for whether the taxpayer is chargeable at two-tiered rates for the 2018/19 provisional tax.

¹ An entity (entity A) has control over another entity (entity B) if entity A, whether directly or indirectly through one or more other entity:

- a) owns or control more than 50% in aggregate of the issued share capital of entity B;
- b) is entitled to exercise or control the exercise of more than 50% in aggregate of the voting rights at general meetings of entity B;
- c) is entitled to more than 50% in aggregate of the capital or profits of entity B; and
- d) in the case entity B being a trust, entity A is entitled to (other than in the capacity of a trustee) a vested interest in more than 50% of the capital of the property of the trust (i) whether the interest is in possession or in remainder or reversion; and (ii) whether the interest is defeasible or not.

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