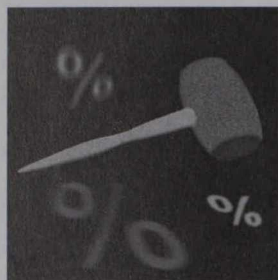
Budget in the black; new developments in profits tax



Legal & Taxation
COMMITTEE

This column is a regular contribution by members of the Chamber's Legal and Taxation Committee.

-Editor and committee chairman Bill Lau.

The budget in brief

Hong Kong's Financial Secretary Mr Hamish Macleod proposed few changes in his second budget speech March 3, 1993. The corporate tax rate is to remain at 17.5 per cent, and the standard salaries tax rate at 15 per cent.

Other salient revenue features of the 1993-94 Hong Kong budget included the reduction of stamp duty on share transfers to 0.3 per cent, the elimination of tax on cosmetics and entertainment (read cinema tickets); plus increased duties on fuel, alcohol and cigarettes. For wage earners, the Financial Secretary is proposing to increase the salaries tax basic personal exemption to HK$56,000 (double that for a married taxpayer). A system of Composite Tax Returns was introduced, effective April 1, 1994, under which a single return will cover all direct taxes levied on a taxpayer.

The Financial Secretary also announced that with effect from March 4, 1993 certain royalty payments, made to an overseas associate for the use of intellectual property would be wholly subject to Profits Tax. Previously, only 10 per cent of such royalty was taxable.

Mr Macleod announced an impressive list of capital projects, and confirmed that Hong Kong's GDP per head had now overtaken that of Spain and New Zealand, and was closing in on that of Australia and the UK.

The only difficulty faced by the Financial Secretary was to explain why he had seriously underestimated Hong Kong's budget surplus, and how his government accumulated HK$20.5 billion over the past fiscal year. Without passing on the former, the Financial Secretary attributed the latter to higher than expected revenues and government underspending. Assuming that underspending is a skill, perhaps Canadian and other governments should consider sending their employees to Hong Kong to be trained by their Hong Kong government counterparts in such skills. It should be noted that the budget proposals may be subject to amendment before being enacted into law.

William Thomson
Tax manager, Deloitte Touche Tohmatsu (HK)

Hong Kong profits tax

The Hong Kong Inland Revenue Department (IRD) recently issued Departmental Interpretation and Practice Note No. 21 on source of profits. For businesses (corporations and individuals) operating in Hong Kong, source of profits is often the most significant Hong Kong tax planning issue, as profits arising outside Hong Kong will escape Hong Kong tax.

This Practice Note provides a clear indication of the IRD's assessing policies in this area. It covers profits arising from a broad range of commercial activities including trading, manufacturing, real estate, services, commission income and financial institutions. Particularly interesting are the comments on a Hong Kong business that carries manufacturing in China under a processing agreement. The IRD's view is that an arbitrary apportionment of 50 per cent of the profits on the sale of such manufactured goods will be subject to Hong Kong tax.

However, the Practice Note states that no apportionment between Hong Kong sources and non-Hong Kong source profits can arise on profits from trading transactions. Such profits will either be wholly taxable or non-taxable, depending on various situations provided in the Practice Note.

It is important to know that this Practice Note only states the IRD's view of this area and it has some ambiguities. It does enable a Hong Kong business to structure its operations to fit into the IRD's assessing policies where advantageous. However, a taxpayer may be able to develop better offshore claim by making reasonable arguments based on his actual situation. The Practice Note is not legally binding and is therefore subject to court decisions.

Barry Macdonald
Principal, Coopers & Lybrand