

The NovaSage View of the 2011/2012 Hong Kong Budget

INTRODUCTION

The Financial Secretary, Mr. John Tsang Chun-Wah, delivered his fourth budget to the Legislative Council on 23 February 2011 and NovaSage provides this commentary with the aim of helping clients understand the effects the budget may have on their personal circumstances and business interests, as well as Hong Kong society in general.

For 2010/11 Hong Kong is expected to record a budget surplus of over \$70 billion, compared to a forecast deficit of \$25.2 billion and Mr. Tsang is optimistic about Hong Kong's economy but emphasised the need to contain inflation and asset bubbles. Following the 2009 downturn, the economy staged a full recovery in 2010 at a faster pace than expected. This was on the back of strong growth in Mainland China and Asia and resulted in the economy surpassing pre-financial tsunami levels with GDP growing by 6.8% in real terms in 2010.

Hong Kong's 2010 exports of goods rose by 17.3% in real terms, regaining ground lost in the financial tsunami. As the employment market improved and income increased, private consumption expenditure showed significant growth of 5.8% in 2010, and overall investment registered growth of 8.1% with the benefit of improved business sentiment and the commencement of major infrastructure projects. It is expected that the economy will grow solidly in 2011.

Whilst the outlook is considered to be positive, Mr. Tsang warned that the economy still faces challenges in 2011. Due to the second round of "quantitative easing" in the U.S., the risk of inflation and asset-price bubbles has increased in Asia, and there is still the sovereign debt crisis in Europe that has not been fully resolved.

Mr. Tsang considers that the risk of inflation is mounting in Asia and with the soft U.S. dollar and likely sustained increases in global food and commodity prices, this will put more inflationary pressure on Hong Kong. Also, the continued rise in Mainland China food prices and local rentals are expected to have a more noticeable effect on Hong Kong's inflation in 2011. It is forecast that the headline and underlying inflation rates will be 4.5% for 2011.

In view of the socio-economic conditions currently affecting Hong Kong, Mr. Tsang proposed increased spending on areas related to people's livelihood, education, health, social welfare and community building. Over \$40 billion of handouts were proposed.

Hong Kong's model of taxation and economic operation will continue unchanged. No changes to tax rates were announced, although increases in some allowances were proposed.

HIGHLIGHTS

The main objectives of the 2010/11 Budget are improving people's livelihood; stabilising the property market; combating inflation, and investing in the future.

Improving People's Livelihood

- Total Government expenditure for 2011/12 is estimated to be \$371.1 billion, 22% up from 2010/11. Total Government revenue is estimated at \$375 billion, giving a predicted surplus of \$3.9 billion in the Consolidated Account.
- 2011/12 recurrent expenditure is estimated at \$242.1 billion, almost 8% up on 2010/11 and the largest growth in the last 10 years.
- 56.4% of recurrent expenditure will go to education, health and social welfare:
 - Education: \$54.5 billion – 6% increase on 2010/11 revised estimate.
 - Social welfare: \$42.2 billion – 11% increase on 2010/11 revised estimate.
 - Health care: \$39.9 billion – 9% increase on 2010/11 revised estimate.

Education

- A self-financing Post-secondary Education Development Fund is to be established, to which \$2.5 billion will be committed.
- The Government Scholarship Fund will receive an injection of \$250 million to extend the benefit to students of publicly-funded sub-degree programmes.
- The income ceiling for the full level of student financial assistance under the means test mechanism will be relaxed and about \$300 million a year will be provided for this. About 75,000 additional students are expected to benefit.
- About \$140 million a year will be provided for the adjustment of the existing tiers of financial assistance for post-secondary students so that those who pass the means test will receive more assistance. Approximately 22,000 post-secondary students should benefit.
- To provide an additional grant of up to \$1,000 for each eligible post-secondary student receiving a grant for academic expenses, about \$48 million a year will be provided. About 52,000 students are predicted to benefit.
- To launch a three year pilot programme in primary schools to provide after-school tutorial services for students from low income families, \$110 million will be reserved.
- \$100 million will be allocated to launch a five-year Mainland Experience Scheme for tertiary students. Over 30,000 students should benefit.

Social Welfare

- The Elderly Health Care Voucher Pilot Scheme will be extended with the allocation of \$1 billion and the value of health care vouchers will be doubled to \$500 per person per year.
- The rates of Community Living Supplement under the Comprehensive Social Security Assistance ("CSSA") scheme will be increased for severely disabled recipients and coverage will be extended to benefit recipients with non-severe disabilities, those in ill health and elderly people. Expenditure for a full year will be about \$590 million and 190,000 recipients should benefit.
- CSSA standard rates will be raised for disabled and ill health recipients under 60 and those aged 60 or above in similar health conditions. About 55,000 should benefit and full year expenditure should be about \$328 million.
- An additional 1,300 subsidised residential care places and 1,700 community care places for the elderly will be provided.
- An integrated discharge support programme for elderly patients will be implemented to increase from 8,000 to about 33,000 those benefiting.

Health Care

- An additional \$2.74 billion of funding will be provided to the Hospital Authority to meet new and increasing demands and implement various healthcare reforms and related initiatives.
- \$1 billion is to be reserved for injection into the Health and Medical Research Fund.
- \$31 million additional funding is to be allocated for strengthening drug regulation and to establish a dedicated office on drugs.
- \$26 million to be allocated to strengthening tobacco control.

Community Building

- A further \$1 billion is to be allocated to improve building safety via Operation Building Bright.
- Heritage conservation will be improved by reserving an additional \$500 million to subsidise more historic building revitalisation projects.
- \$7 billion is to be spent on setting up an Elite Athletes Development Fund.
- An allocation of over \$2.8 billion will be made for the development of art and cultural software.

Stabilising the Property Market

The supply of land is to be increased by measures including:

- Specifying four residential sites in the Application List for government initiated sale by open auction.
- Putting up for sale by tender five residential sites, the use of which will be restricted to construction of about 3,000 small and medium-sized flats.
- In 2011/12, a total of 52 residential sites will be made available for sale, comprising 18 new sites and 34 sites rolled over from the 2010/11 Application List.
- The housing land available in 2011/12 is estimated to provide 30,000 to 40,000 private residential flats, an increase on the annual average of 20,000 flats.
- New public rental housing flat production for 2011/12 and 2012/13 is predicted to be 11,200 and 16,700 flats respectively.
- More suitable sites for the My Home Purchase Plan are to be identified.
- Reclamation outside Victoria Harbour and the development of rock caverns are to be explored.

Combating Inflation

- Government rates will again be waived for 2011/12, subject to a ceiling of \$1,500 per quarter for each rateable tenement. About 82% of properties will not need to pay rates.
- The electricity subsidy of \$1,800 for each residential electricity account will be extended to 2011/12 at a cost of \$4.7 billion and benefiting over 2.6 domestic accounts.
- Public housing tenants will have two months' rent paid for them at a cost of \$4.7 billion.
- An extra month's CSSA payment, Old Age Allowance and Disability Allowance will be provided at a cost of \$1.9 billion. Also, those allowances will be adjusted as necessary in the middle of the year.
- The tax deductible Child Allowance will be increased by 20%, benefiting over 300,000 taxpayers.
- The Dependent Parent/Grandparent Allowances and the ceiling for Elderly Residential Care expenses will be increased by 20%. About 510,000 taxpayers should benefit.
- A one-off contribution of \$6,000 will be made to each Mandatory Provident Fund account so that retirement savings are increased.
- A reserve of an additional \$100 million will be made for injection into short-term food assistance services, as and when needed.
- Between \$5 billion and \$10 billion of Hong Kong dollar inflation linked retail bonds ("iBond") to be issued.

Note: The waiver of the \$2,000 levy comprised in the annual Business Registration fee that all Hong Kong companies and businesses must pay has not been extended. *Therefore, with effect from 1 August 2011 the standard Business Registration fee payable will be \$2,450.*

Investing in the Future

The Financial Secretary has said that the Government is committed to investing in the future of Hong Kong and will:

- Invest continuously in infrastructure to promote growth.
- Maintain a steady and adequate supply of Grade A offices to enhance Hong Kong's competitiveness.
- Develop new high grade office clusters. This will include developing the old Kai Tak Airport site into another premier office node and putting up for sale two business sites in Kwun Tong and Kowloon Bay.
- Continue to enhance the competitiveness of the four traditional pillar industries.
- Promote the development of industries where Hong Kong enjoys clear advantages, promote wine trading and explore new opportunities in emerging markets to promote the diversification of Hong Kong's economy.
- Strengthen cooperation with Guangdong Province, Macau, Taiwan and other regions to sharpen our competitive edge in the global market.
- Enhance the business environment to attract enterprises from all over the world to set up business in Hong Kong.
- Support small and medium enterprises ("SMEs") by increasing the total guarantee commitment under the SME Loan Guarantee Scheme to \$30 billion.

Other Measures

- Public health is to be protected by increasing tobacco duty by 50 cents per cigarette and by the same rate on other tobacco products.
- In an attempt to contain the growth in the number of private cars on Hong Kong's roads the first registration tax will be increased by about 15%.

Please visit the official home page <http://www.budget.gov.hk/2011/eng/speech.html> of the 2011/12 Hong Kong budget where you can view Mr. John Tsang's full speech.

PROFITS TAX

The budget for the fiscal year 2011/12 proposed no changes to Profits Tax rates or allowances. Below is a summary of the various tax rates and allowances that are still applicable:

Profits Tax Rates	2011/12
Corporations	16.5%
For Unincorporated businesses	15%

Capital Allowance Rates	2011/12
Depreciation allowances on plant and machinery	
- initial	60% of qualifying expenditure in the year the expense was incurred.
- annual	prescribed rate of 10%, 20% or 30% on reducing value, depending on the type of plant or machinery.

The cost of computer software, hardware and computer systems can be fully written-off in the year the expenditure is incurred.

Industrial building allowances	
- initial	20% available in relation to the cost (excluding the land cost) for buildings occupied for the purpose of a qualifying trade.
- annual	4% of the original qualifying capital expenditure.

Environment friendly equipment and building installations	
- annual	20% of the capital expenditure.

Note:

- There is no tax in Hong Kong on capital gains, dividends (whether from Hong Kong sources or otherwise) and foreign-sourced interest or interest from deposits placed with Hong Kong authorised institutions.
- There is no withholding tax on dividends paid to non-resident shareholders.
- Royalties paid to non-resident persons for the use of intellectual property are subject to withholding tax. The prescribed percentage is 5.25% of the gross payment if the payer and the recipient are not related, but 16.5% if the payer and recipient are related.

Other Matters Affecting Businesses

- In last year's budget the Business Registration fee was waived for one year. Previously, a \$2,450 fee and levy was payable, but this was reduced to \$450 on 1 August, 2009. This reduction continues to be effective until 31 July 2011 but from 1 August 2011 the standard Business Registration fee will revert to \$2,450 per annum.

SALARIES TAX

The budget for the fiscal year 2011/12 proposed no changes to the rates of salaries tax but proposed some increases in allowances.

The rates, allowances and deductions applicable to Salaries Tax for 2011/12 are as follows:

Salaries Tax	2011/12
Standard Rate of Tax	15%
Progressive Rates of Tax	
Net Chargeable Income	Tax Rate
First \$40,000	2%
Next \$40,000	7%
Next \$40,000	12%
Remainder	17%

Note: The Salaries Tax charge is the lower of:

- (a) the net assessable income less charitable donations and allowable deductions at the standard rate; or
- (b) the net assessable income less charitable donations, allowable deductions and personal allowances charged at progressive rates.

Allowances	2011/12
Personal Allowances:	
Basic	\$108,000
Married	\$216,000
Single Parent	\$108,000
Additional Allowances:	
Child Allowances	
Year of Birth (increased by \$20,000 to)	\$120,000
1 st to 9 th child (each) (increased by \$10,000 to)	\$60,000
Dependent Parent/Grandparent	
Aged 60 or more	
Basic (increased by \$6,000 to)	\$36,000
Additional Allowance (increased by \$6,000 to)	\$36,000
Aged 55 to 59	
Basic (increased by \$3,000 to)	\$18,000
Additional Allowance (increased by \$3,000 to)	\$18,000
Dependent Brother/Sister	\$30,000
Disabled Dependent	\$60,000

Deduction Ceiling	2011/12
Self-education expenses	\$60,000
Home loan interest	\$100,000
Approved charitable donations	35% of income
Elderly residential care expenses (increased by \$12,000 to)	72,000
Contributions to recognised retirement scheme	12,000

OTHER TAXES, RATES, DUTIES AND MEASURES

Property Tax

The Property Tax rate remains the same. Property owners are taxed on rental income at a standard rate of 15% of the net assessable value.

Government Rates

Government rates are proposed to be waived for 2011/12, subject to a ceiling of \$1,500 per quarter for each rateable property.

Capital Duty

There has been no change in the capital duty, which is levied at 0.1% of the increased in authorised share capital, subject to a cap of \$30,000 per case.

Stamp Duty

Property Transactions

The stamp duty on transactions of properties valued at more than \$20 million was increased with effect from 1 April 2010 from 3.75% to 4.25% and, the rates for stamp duty on property transaction are as follows:

Property Consideration	W.E.F. 1 April 2010
Up to \$2,000,000	\$100
\$2,000,001 to \$3,000,000	1.5%
\$3,000,001 to \$4,000,000	2.25%
\$4,000,001 to \$6,000,000	3.00%
\$6,000,001 to \$20,000,000	3.75%
More than \$20,000,000	4.25%

On 19 November 2010 it was announced that to combat speculative activity in the residential property market a Special Stamp Duty ("SSD") would be introduced for any residential property acquired on or after 20 November 2010, which is sold within 24 months of acquisition. The SSD is payable on the higher of the consideration for the transaction or the market value of the property at the following rates:

- (i) 15% if the vendor held the property for six months or less;
- (ii) 10% if the vendor held the property for more than six months but for 12 months or less;
- (iii) 5% if the vendor held the property for more than 12 months but for 24 months or less.

Hong Kong Stocks

Stamp Duty on the sale or purchase of any Hong Kong stock is charged at rates that vary with the amount or value of the consideration as follows:

Nature of Document	Tax Rate
Contract Note for sale or purchase of any Hong Kong stock	0.1% of the amount of the consideration or of its value on every sold note and every bought note
Transfer operating as a voluntary disposition inter vivos	\$5 + 0.2% of the value of the stock
Trading of exchange-traded funds (ETFs) that track indices comprising not more than 40% of Hong Kong stocks	Waived
Transfer of any other kind	\$5

Tobacco Duty

The duty on tobacco sold locally has been increased as follows:

	Previous	W.E.F. 23 February 2011
Cigarettes (per 1,000 sticks)	\$1,206	\$1,706
Cigars (per Kilo)	\$1,553	\$2,197
Chinese prepared tobacco (per Kilo)	\$296	\$419
All other manufactured tobacco except tobacco intended for the manufacture of cigarettes (per Kilo)	\$1,461	\$2,067

Others

First Registration Tax on Private Cars

Tax Bands	Present tax rates	Proposed tax duties
(a) On the first \$150,000 of taxable value	35%	40%
(b) On the next \$150,000	65%	75%
(c) On the next \$200,000	85%	100%
(d) On the remainder (i.e. on taxable value over \$500,000)	100%	115%

Other duties and charges remain unchanged.

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