

The Inland Revenue (Amendment) (No. 3) Ordinance 2018 (“the Ordinance”)

Two-tiered Profits Tax Regime

August 7, 2018

The Inland Revenue (Amendment) (No. 3) Ordinance 2018 was enacted on March 29, 2018. The amendment ordinance has introduced two-tiered profits tax rates regime be applicable to any year of assessment commencing on or after April 1, 2018.

The profits tax rate for

➤ Corporations (e.g. limited company)

The first HK\$2 million of profits earned by a company will be taxed at half the current tax rate (i.e., 8.25%) whilst the remaining profits will continue to be taxed at the existing 16.5% tax rate.

➤ Unincorporated businesses (i.e. partnerships and sole proprietorships)

The first HK\$2 million of profits earned will be taxed at half of the current tax rate (i.e., 7.5%) whilst the remaining profits thereafter will be taxed at the existing 15% tax rate.

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

The key objectives of the Profits Tax bill are to maintain a competitive taxation system to promote economic development, while maintaining a simple and low tax regime. However, for two or more connected entities, only one of them may elect the two-tiered profits tax rates.

The introduction of the two-tiered profits tax regime would:

- Reduce the overall tax burden on enterprises especially for SMEs (SMALL and MEDIUM ENTERPRISES);
- Allow enterprises to reinvest the tax savings in upgrading their hardware and software to boost their overall operations and efficiency;
- Enable the more successful social enterprises to pursue their social objectives (e.g., creating more employment and training opportunities for the socially disadvantaged) by alleviating their tax burden; and
- Boost Hong Kong’s status as the preferred investment jurisdiction.

Example:

Corporation (limited company) – Assessable Profit			
	2018/19	Provisional Tax 2019/2020	Tax Payable
HK\$1,800,000 x 8.25%	HK\$148,500	HK\$148,500	HK\$297,000
HK\$2,200,000			
First HK\$2,000,000 x 8.25%	HK\$165,000	HK\$165,000	
Balance HK\$200,000 x 16.5%	HK\$33,000	HK\$33,000	HK\$396,000

Remarks:

For two or more connected entities, only one of them may elect the two-tiered profits tax rates. There is an extensive definition of “connected entity” in the legislation which is designed to ensure that a group of connected taxpayers can benefit from the one-half reduction only in respect of one of such connected taxpayers. For this purpose, the group will need to identify which entity will benefit and to make an election accordingly. The election, once made, is irrevocable in respect of a particular year of assessment.

Example of connected entities:

Peter Chan and David Wong own the following companies which share structure as follows:

ABC Limited	XYZ Limited
Peter Chan – 51%	Peter Chan – 51%
David Wong – 49%	David Wong – 49%

Then, these 2 companies are classified as connected entities, only 1 company can entitle to apply for two-tiered profits tax regime.

Peter Chan owns the following companies which share structure as follows:

ABC Limited	XYZ Limited
Peter Chan – 100%	Peter Chan – 100%

Then, these 2 companies are classified as connected entities, only 1 company can entitle to apply for two-tiered profits tax regime.

It will be important for businesses with related entities (e.g., corporate groups) to review their existing structures as each group will have to nominate one member in the group to benefit from the reduced tax rate.

In order to avoid double benefits, the following enterprises shall be excluded from the two-tiered profits tax regime:

- enterprises electing the preferential half-rate tax regimes (e.g., professional reinsurance companies, captive insurance companies, corporate treasury centres and aircraft leasing companies); and
- 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).

There will be an anti-fragmentation measure to prevent corporate activities from being divided amongst a large number of companies who could benefit from the lower tax rate - each group will have to nominate only one company in the group of companies to benefit from the progressive rate.

For further details of the two-tier profits tax regime, please see <https://www.ird.gov.hk/eng/faq/2tr.htm>