L&P

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The Budget of Hong Kong 2016/2017

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I. Introduction

The Financial Secretary of Hong Kong, John Tsang, held his annual budget report for the 2016/2017 budget year of Hong Kong on 24 February 2016.

Even though the economy slowed down in Hong Kong, mainly because of less visitors from Mainland China, the Hong Kong government forecasts a surplus of HKD 30 billion (approx. EUR 3.5 billion) at the end of the financial year (31 March 2016). This is lower than the anticipated HKD 36 billion (approx. EUR 4.2 billion) and much lower than the estimation of between HKD 72 billion and HKD 90 billion (approx. EUR 8.4 – 10.5 billion) which were raised in the last weeks by several big audit firms.

II. The Highlights

1. Economic Performance 2015/2016

Due to the economic slowdown in Mainland China, Hong Kong suffered an economic setback as well. Export of goods and services, inbound tourism and retail sales decreased. However, domestic demand and infrastructure spending led to an overall Gross Domestic Product ("**GDP**") growth of 2.4 percent, the fourth consecutive year with a growth rate lower than the annual average of 3.4 percent over the past decade.

The unemployment rate averaged at a low level of 3.3 percent for the year as a whole, sustaining a state of full employment. The headline inflation rate was 3 percent.

The revised estimate for government revenue is HKD 457 billion (approx. EUR 53.5 billion) and, therefore, 4.2 percent (or HKD 20 billion) lower than originally estimated.

The fiscal reserves are estimated to be at HKD 860 billion (approx. EUR 95 billion) by the end of March 2016, **equivalent to 24 months of government expenditure** (the reserves are amongst the largest worldwide).

2. Outlook for 2016/2017

As 2016 is starting unsteady, the forecast is rather cautious. Though the U.S. Federal Reserve increased the interest rate, the Eurozone and Japan have kept their policies of quantitative easing. Additionally, emerging economies and Mainland China are still facing pressure.

Facing internal and external challenges, the Financial Secretary forecasts a GDP growth of 1 – 2 percent in 2016. The inflation is forecasted to fall to the level of 2.3 percent.

Taking this into account, the Financial Secretary forecasts a surplus of (only) HKD 11 billion (approx. EUR 1.3 billion) for the coming year 2016/2017.

Fiscal reserves are estimated to increase to HKD 870 billion (approx. EUR 102 billion) by the end of March 2017, representing 35.2 percent GDP or equivalent to 21 months of government expenditure.

3. Relief Measures

As every year, the public expected the government to announce several relief measures in order to ease the financial burden of the taxpayers. This year, the measures target especially the tourism sector, small and medium-sized enterprises and the middle class:

a) Helping SMEs

Small and medium-sized enterprises ("**SMEs**") employ approx. 50 percent of the private sector workforce. The Financial Secretary will take the following measures to ease the tax burden on SMEs in Hong Kong.

- Reducing the profits tax for 2015/2016 by 75 percent, subject to a ceiling of HKD 20,000 (approx. EUR 2,300) (actually max 15 percent).
- Waiving the business registration fees for 2016/2017.
- Starting a "Pilot Technology Voucher Programme" under the "Innovation and Technology Fund" to subsidies the use of technological services to improve and upgrade business processes. The subsidies are capped at HKD 200,000 (approx. EUR 23,500) for each eligble SME.

b) Supporting Tourism

Tourism contributes five percent to Hong Kong's GDP. In light of decreasing numbers of tourists (mostly due to less tourists from Mainland China, and the strong Hong Kong Dollar), the Financial Secretary wants to develop tourism towards diversified and quality-driven high value-added services to better accommodate high-spending overnight visitors. The measures include:

- Waiving certain licence fees for travel agents, hotels, guesthouses and restaurants.
- Expanding the scale of major events held in Hong Kong.
- In the long run, projects such as Disneyland and other franchises will be promoted. Hong Kong will also start a pilot scheme regarding food trucks.

c) Easing Financial Pressure

Mr. Tsang announced several measures to ease financial pressure and to stimulate local consumption and economic growth. The measures include reduced salaries tax and raised allowances. The measures are in detail:

- Reducing the salaries tax by 75 percent, subject to a ceiling of HKD 20,000 (approx. EUR 2,300). Considering the tax reduction, the effective income tax rate is approx. 8 to 10 percent, depending on the taxpayers' income. However, a majority of employees in Hong Kong do not have to pay salary tax at all.
- Providing an extra tax deductible allowance to social security recipients, equal to one month of the standard rate Comprehensive Social Security Assistance payments, Old Age Allowance, Old Age Living Allowance and Disability Allowance.
- Increasing the basic tax deductible allowance (minimizing the tax base) from HKD 120,000 to HKD 132,000 (approx. EUR 15,400).
- Increasing the single tax dedutabal parent allowance from HKD 120,000 to HKD 132,000, and increasing the married person's allowance from HKD 240,000 to HKD 264,000 (approx. EUR 30,800).
- Increasing the tax deductible allowance for maintaining a dependent parent or grandparent aged 60 or above from HKD 40,000 to HKD 46,000 (approx. EUR 5,400).
- Increasing the tax deductible allowance for maintaining a dependent parent or grandparent aged between

55 and 59 from HKD 20,000 to HKD 23,000 (approx. EUR 2,700).

- Raising the deduction ceiling for elderly residential care expenses from HKD 80,000 to HKD 92,000 (approx. EUR 10,800) for taxpayers whose parents or grandparents are admitted to residential care homes.

4. New World Economy

To maintain competitiveness, Hong Kong will strengthen its profile regarding innovations and new markets with the following measures:

a) Innovation

- Enhancing efforts in research and development.

- Improving tools and means regarding financial technology (Fintech), including ease of business and ensuring consumer protection

- Helping start-ups and entrepreneurs by providing a HKD 2 billion (approx. EUR 235 million Innovation and Technology Fund, expanding the Science Park to accommodate further offices and continuing to support start-ups through the Corporate Venture Fund.

- Boosting creative industries such as fashion and design, film and arts and sports.

b) Finding new Markets

- Hong Kong will continue to support the efforts regarding the "Silk Road Economic Belt and the 21st-century Maritime Silk Road". Hong Kong will hold the inaugural Belt and Road Summit in May 2016.

- Hong Kong will continue expanding trading networks, namely pressing for a free trade agreement with the Association of Southeast Asian Nations (ASEAN). Hong Kong will also seek discussion with Macau regarding a closer economic partnership.

- Hong Kong will expand the airport to a three-runway system, providing capacities for 100 million passengers and 9 million tonnes of cargo by 2030.

- Regarding Hong Kong's relevance to RMB trade settlement, the government continues exploring ways to open up more channels for two-way cross-border RMB fund flows, including increasing the investment quota.

- The Financial Secretary will issue a new iBond of up to HKD 10 billion (approx. EUR 1,2 billion) with a maturity period of three years following the existing practice.

5. Situation and Intentions

The Financial Secretary emphasizes that expenditure growth needs to be contained, due to an aging population and a shrinking workforce.

Given the latest discussion of rising costs of infrastructure projects, the Financial Secretary will deepen the efforts of controlling costs by establishing a special office regularly reporting on figures and progress.

Mr. Tsang says he hopes the Mainland will further deepen liberalisation measures embarked on this year with Guangdong and Hong Kong and extend them nationwide, thereby achieving basic liberalisation of trade in services between the entire Mainland and Hong Kong by the end of this year.

III. Conclusion

For the first time in recent years, Mr. Tsang's estimates matched the reality. Mr. Tsang has a reputation for underestimating the surplus which was criticised as damaging to Hong Kong's allocation of expenditures.

Hong Kong is still trying to reduce its expenditures, but most of the measures remain unchanged. The 2016/2017 budget does not move away substantially from the line taken in recent years. Mr. Tsang propagandized a conservative finance policy to be prepared for future challenges. As in previous years, the main criticism on the budget is that it provides several short term relief measures that might help to support local consumption, but the tax basis remains very narrow. Many experts claim that Hong Kong needs a substantial overhaul of its tax system (including a discussion whether to introduce a sales tax, VAT) in order to be prepared for the estimated economic downturn of the coming years.

We believe that the information provided was helpful for you.
If you have any further questions, please do not hesitate to contact:

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