Hong Kong: Is a tax deduction for rental payments beneficial to individual taxpayers?

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In brief

Financial Secretary Paul Chan recently stated that the government is looking into the option of allowing a tax deduction for rental payments, given the financial burden on Hong Kong residential tenants from rising rents. While it may take some time for the details to be announced, it may be worthwhile to consider the potential impact of a rental deduction on salaried income earners.

The tax benefit that would be derived from this proposed deduction may not be significant depending on whether there will be a limit on the amount of deduction that can be claimed. Under existing rules, rental reimbursements from employers are not taxable if proper arrangements are in place, while the taxable amount of the housing benefit generally is computed at 10% of other income. The current rules allow employers to provide tax-efficient rental reimbursement benefits to employees. As a result, the government also may consider encouraging more employers to implement such arrangements as well as providing greater clarity on the related requirements.

In detail

New tax deduction under consideration

Financial Secretary Paul Chan delivered the 2018/19 Budget on February 28, 2018. During his subsequent meeting with the press, the Financial Secretary mentioned that a tax deduction on rental expense for individual taxpayers is under consideration by the government, in order to lessen the pressure many tenants are now facing in Hong Kong due to rising rents. No further details have been announced.

The tax benefit to an individual taxpayer from this proposed deduction could depend upon various factors, such as the level of income, amount of rental expense, and whether there is a limit on the allowable amount of deduction. If there is a low limit, the resulting tax benefit may not be significant to individual taxpayers, especially when the rental costs in the market continue to rise.

Existing provisions in Inland Revenue Ordinance

Under current provisions, when an employee is provided with a place of residence by the employer, the Inland Revenue Department (IRD) assesses a rental value on the place of residence that is included in the employee's taxable income from a Hong Kong salaries tax perspective. This occurs instead of taxing the amount of the actual rental expenses. Similarly, when the employer reimburses the rental expense of an employee by establishing clear guidelines and exercising proper control over the reimbursement process, the IRD accepts the arrangement as if the employer directly provided a place of residence to the employee.

The rental value is included in the assessable income of the employee, whereas the amount of rental reimbursement is not treated as taxable income.

Some employers in the market have implemented rental reimbursement schemes for their employees in order to provide competitive remuneration packages and enhance tax efficiency.

Proposed tax deduction versus reimbursement scheme

The implications to an individual taxpayer can be different if a tax deduction for rental expense is in place as compared to a rental reimbursement scheme implemented by an employer. The potential difference in salaries tax liability is summarized in the example below.

Example

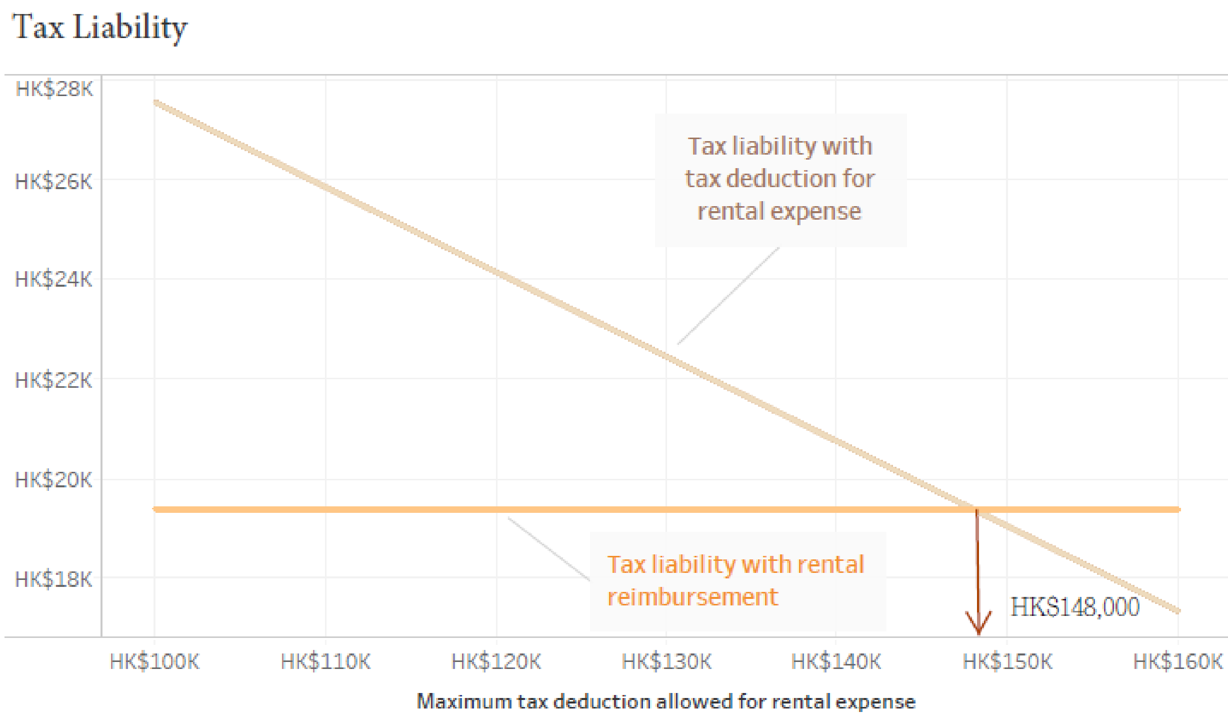
Assume a single individual earns annual employment income of HK$500,000 and he/she incurs rental cost of HK$150,000 per year on a primary residence. The table below compares the differences in salaries tax liabilities under four scenarios based on the tax rates for the year of assessment 2018/19. In addition to the base case, the scenarios include:

- (i) limit on allowable rental expense deduction is HK$50,000 per tax year
- (ii) limit on allowable rental expense deduction is HK$100,000 per tax year
- (iii) employer of the individual properly structures HK$150,000 out of the individual's income as rental reimbursement benefits.

(HK$)	Base case without any deduction	(i) Deduction capped at HK$50,000	(ii) Deduction capped at HK$100,000	(iii) Rental reimbursement
Tax liability	44,560	36,060	27,560	25,010
Decrease in tax liability (%) as compared to the base case		**19%**	**38%**	**44%**
If the rental cost is increased to HK$180,000:				
Tax liability	44,560	36,060	27,560	19,400
Decrease in tax liability (%) as compared to the base case		**19%**	**38%**	**56%**

In the above example, if the tax deduction on rental expense is set at HK$50,000 or HK$100,000 per year, the percent of tax saving is about 19% or 38% respectively. However, when there is an increase in rent, the amount of tax saving will remain the same; in other words, the attractiveness of such deduction will be reduced. On the other hand, if the rental expense is within the allowable amount of deduction or in the case of rental reimbursement, the amount of tax saving will be increased alongside with the increase in rental cost.

Using this example, the graph below shows how the tax liability deviates while the limit of tax deduction allowed for rental expense increases. In general, with annual rental expense of HK$180,000 and annual income of HK$500,000, the tax efficiency achieved by a tax deduction can only outweigh the savings achieved by rental reimbursement if the maximum amount of deduction allowed for rental expense is at or above HK$148,000.



The takeaway

The details of a possible tax deduction for rental expense still are being considered by the government. The potential tax benefit to taxpayers is uncertain, especially depending on whether there will be a limit on the allowable amount of deduction.

The examples above illustrate the tax implications of a hypothetical rental deduction for tax purposes as compared to the rental reimbursement schemes that can be implemented by employers under existing law. Rental reimbursement schemes commonly have been implemented by employers in the marketplace and have proven to lighten the tax burden for employees, provided that such schemes are properly set up.

While considering a rental payment deduction for salaries tax purposes, the government also could encourage more employers to deploy rental reimbursement schemes for their employees. In addition, the IRD may want to provide more clarity on the requirements for a proper rental reimbursement scheme, including:

- the percentage of income that can be structured as rental reimbursement benefits
- content to be covered in employers' rental reimbursement policies and other required documentation
- the mode and timing of confirming an employee's entitlement to rental reimbursement benefits
- whether original tenancy agreements and rental receipts are required to be submitted by employees to employers for verification
- how often employers should review the tenancy agreements and rental receipts of employees, etc.

Employers who have rental reimbursement schemes already in place, or are interested in setting up such schemes, should understand the prevailing requirements, rules, and IRD practices. As a final note, employers and individual taxpayers are reminded that any incorrectly reported rental reimbursement benefits to the IRD may be subject to penalties.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your regular Global Mobility Services engagement team or one of the following team members:

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