Public Finance

The Hong Kong Special Administrative Region (HKSAR) exercises a high degree of autonomy in its financial affairs, with the ultimate authority resting with its Legislature. It is financially self-supporting.

Budgetary Process: Starting from October every year, draft estimates of government expenditure and revenue for the ensuing financial year are prepared. They are usually laid before the Legislative Council in February. Expenditure is authorised upon the enactment of an Appropriation Ordinance to the extent that they are provided for in that ordinance.

On the introduction of the Appropriation Bill into the Legislative Council, the Financial Secretary may announce new revenue proposals although he may also do so at any other time.

Budgetary Position: As at March 31, 2010, the Government's fiscal reserves stood at $520.3 billion.

The budget for 2010/11 provides for estimated revenue of $292 billion and expenditure of $317.2 billion, resulting in an estimated deficit of $25.2 billion.

Public Expenditure: Public expenditure in the context of the economy is conventionally taken to comprise expenditure by the Housing Authority, the trading funds, and all government expenditure charged to the General Revenue Account, the Capital Works Reserve Fund, the Loan Fund, the Lotteries Fund, the Disaster Relief Fund, the Civil Service Pension Reserve Fund, the Innovation and Technology Fund, the Land Fund and the Capital Investment Fund. Expenditure by institutions in the non-government sector is included to the extent of their subventions by the Government.

Public expenditure does not include expenditure by those organisations in which the Government has only an equity position, such as the MTR Corporation Limited and the Airport Authority.

Public expenditure, as defined above, is estimated to be $337.8 billion for 2010/11. This represents about 19.8 per cent of Gross Domestic Product (GDP).

The Housing Authority, operating through the Housing Department, is also financially autonomous. Its income is derived mainly from public housing estates rentals.

A trading fund is a financial and accounting entity, established by a resolution of the Legislative Council, in accordance with the provisions of the Trading Funds Ordinance (Chapter 430 of the Laws of Hong Kong). It enables a government department to provide services on a commercial or quasi-commercial basis. Its expenditure is financed from fees and charges for the services provided. The existing five trading funds are: Companies Registry Trading Fund, Land Registry Trading Fund, Office of the Telecommunications Authority Trading Fund, Post Office Trading Fund and Electrical and Mechanical Services Trading Fund.

The *Capital Works Reserve Fund* is used to finance Government's Public Works Programme, land acquisitions, capital subventions, major systems and equipment, computerisation projects and the payment of redemption money in respect of land exchange entitlements. Its income is derived mainly from land premium and investment income.

The *Loan Fund* is used mainly to finance loans schemes such as housing loans and education loans. It is funded mainly by loan repayments and interest.

The *Lotteries Fund* is used to finance welfare services through grants and loans. It derives its income mainly from a share of the proceeds of the Mark Six Lottery and investment income.

The *Disaster Relief Fund* provides a ready mechanism for Hong Kong to respond swiftly to international appeals for humanitarian aid in relief of disasters that occur outside Hong Kong. Total grants paid out of the fund amounted to $99 million in 2009/10. Transfers are made as necessary from the General Revenue Account to the Disaster Relief Fund to meet its commitments.

The *Civil Service Pension Reserve Fund* provides a reserve to meet payment of civil service pensions in the unlikely event that the Government cannot meet its liabilities for such payment from the General Revenue Account. Its income is derived from Investment income.

The *Innovation and Technology Fund* is used to finance projects that help promote innovation and technology upgrading in manufacturing and service industries. It is funded mainly by investment income.

The *Land Fund* was established on July 1, 1997 to enable the investments held by the former Trustees of the HKSAR Government Land Fund to be formally brought into the Government's account. Its income is derived from investment income.

The *Capital Investment Fund* is used to finance the government's capital investments, such as equity injections to the Airport Authority and the MTR Corporation Limited, and capital investments in the Housing Authority and the Urban Renewal Authority. It is funded mainly by dividends, investment income and loan repayments.

The *Bond Fund* is a statutory fund established in July 2009 to hold the sums raised under the Government Bond Programme ("GBP"), and to repay the financial obligations arising from and associated with the GBP, which is an initiative launched by the Government to promote the further and sustainable development of the local bond market. The Bond Fund is managed separately from other government accounts and the fiscal reserves. Moneys in the Bond Fund are invested by the Hong Kong Monetary Authority, adopting the same investment arrangement as that for the Exchange Fund. The same "fixed rate" sharing arrangement for determination of the investment income applicable to the fiscal reserves applies to the calculation of investment return generated from the Bond Fund.

Medium Range Forecast: The Government prepares a Medium Range Forecast in the context of its annual budget. This is a five-year forecast of expenditure and revenue which focuses on the consolidated financial position of the Government. Revenue projections reflect fiscal policies, the general economic outlook and forecast patterns of collection. Expenditure projections take account of expected increases in the demand for and supply of government services.

The forecast constitutes not a plan but a baseline against which progress can be measured and the need for further action assessed.

Revenue Sources: Hong Kong is a free port and does not levy any tariffs on imports. However, excise duties are collected on a few items of commodities consumed locally irrespective of whether they are imported or manufactured locally. The dutiable commodities are tobacco, liquor with an alcoholic strength above 30%, methanol, aircraft spirit, motor spirit and light diesel oil. All companies engaged in the import, export, manufacture or storage of the aforesaid commodities must be licensed.

Rates are levied on landed properties at a percentage of the assessed rateable value which is, briefly, the annual rent at which the property might reasonably be expected to be let. Rateable values are updated each year by way of a general revaluation to reflect changes in market rents. The current Valuation List took effect on April 1, 2010.

The percentage charge on rateable values is determined by resolution of the Legislative Council. The current rates percentage charge is 5 per cent.

Government rent is payable during the term of new land leases or the extended term of non-renewable land leases. This annual rent is levied at 3 per cent of the rateable value of the property and is adjusted in step with any subsequent changes in rateable value.

Betting duty is imposed on the gross profits from horse racing, the proceeds of Mark Six Lottery and the gross profits from the conduct of authorised betting on football matches. The duty is charged at a set of progressive rates from 72.5 per cent to 75 per cent on the gross profits from horse racing, 25 per cent on the proceeds from Mark Six Lottery and 50 per cent on the gross profits from football betting.

Estate duty is imposed on that part of a deceased's estate situated in Hong Kong. Following the abolition of the duty on February 11, 2006, no estate duty will be charged on the estates of persons deceased on or after that date.

Fixed or ad valorem *Stamp Duty* is imposed on different classes of documents relating to transactions of immovable property, leases and share transfers.

Earnings and profits tax is levied under the Inland Revenue Ordinance. Hong Kong has a schedular system of taxation whereby persons liable are assessed and required to pay tax on three separate and distinct sources of income, namely, business profits, salaries and property. However, individuals may have their total income from all sources aggregated under personal assessment.

Profits tax is charged only on profits arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong. Profits of unincorporated businesses are taxed at 15 per cent whereas profits of corporations are taxed at 16.5 per cent. Assessable profits are determined from the profits made in the relevant accounting year for each year of assessment. There is no withholding tax on dividends paid by corporations, and dividends received from corporations are exempt from tax.

Salaries tax is charged on emoluments arising in or derived from Hong Kong. Tax payable is calculated on a sliding scale which varies from 2 to 17 per cent on every $40,000 segments of income (that is, income after deductions and allowances). The total tax is restricted to a maximum of 15 per cent of the income before allowances.

Property tax is charged on the owner of land or buildings in Hong Kong at the standard rate of 15 per cent on the rent received, less an allowance of 20 per cent for repairs and maintenance. A property owned by a corporation carrying on business in Hong Kong is exempt from property tax but the profits derived from the property are chargeable to profits tax.

Other revenue arises from taxes on the first registration of motor vehicles, the Air Passenger Departure Tax, fines, forfeitures and penalties, royalties and concessions, yields from properties and investments, land transactions, reimbursements and contributions, government utilities, and from fees and charges for the provision of a wide range of goods and services.

Audit of Public Accounts: The audit of all of the Government's accounts is carried out by the Director of Audit and his staff. He also audits the accounts of the Housing Authority, five Trading Funds and more than 60 statutory and non-statutory funds and other public bodies. The work of the Audit Commission includes value for money audits, which are essentially an examination into the economy, efficiency and effectiveness with which any organisation under audit has been discharging its functions. The Director's duties and powers are set out in the Audit Ordinance. The Audit Ordinance also provides that the Director shall not be subject to the direction or control of any other person or authority.

The Director submits in October each year a report on his examination and audit of the financial statements of the Government for the previous financial year. The Director of Audit's report on the results of value for money audits completed between March and September is also submitted in October each year. The report on the results of value for money audits completed between October and February is submitted in April each year. After submission to the President of the Legislative Council, the Director's reports are considered by the Public Accounts Committee of the Council.

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