PKF Hong Kong

2024-25 Tax Updates

Tax Deduction for Leased Premises Reinstatement and Allowances for Buildings and Structures

Background

In the 2024-25 Budget, the Financial Secretary announced two tax initiatives aimed at supporting businesses: (1) the introduction of a tax deduction for expenses related to reinstating leased premises to their original condition ("reinstatement costs"); and (2) the removal of the time limit for claiming the commercial building allowance ("CBA") and industrial building allowance ("IBA") for buildings or structures, effective from the year of assessment 2024/25. To implement these proposals, the Inland Revenue (Amendment) (Tax Deductions for Leased Premises Reinstatement and Allowances for Buildings and Structures) Bill 2024 ("the Amendment Bill") was gazetted on 18 October 2024 and introduced to the Legislative Council for its First Reading on 30 October 2024.

1. Proposed Tax Deduction for Lease Reinstatement Costs

The Government has proposed a new tax deduction for expenses incurred in reinstating leased premises to their original condition at the end of a lease term. Currently, such reinstatement costs are considered capital expenditures and are not deductible under Section 17(1)(c) of the Inland Revenue Ordinance (Cap. 112) ("IRO"), but the proposed amendment aims to alleviate the tax burden on enterprises that frequently relocate or renovate their operational spaces.

Effective from the year of assessment 2024/25, taxpayers will be permitted to claim a deduction for reinstatement costs, provided all the following conditions are met:-

- The reinstatement costs have been incurred by the claimant.
- The claimant is a lessee of the lease.
- The claimant has an obligation to reinstate or to pay in part for the reinstatement of the premises.
- The reinstatement costs must not be associated with any provisions under Hong Kong Financial Reporting Standard 16 (Leases).
- The claimed amount of the reinstatement costs must be reasonable based on the circumstances.

The term "reinstatement costs" refers to expenses related to restoring the premises to their original condition and includes payments made to the lessor to discharge a reinstatement obligation. The term "reinstatement obligation" is defined as an obligation (whether expressed or implied and whether arising from the lease or from another arrangement between the lessor and the lessee) to reinstate, or to pay in full or in part for the reinstatement of, the leased premises to their original condition at the end of the lease or upon early termination of the lease.

2. Removal of Time Limit for Claiming CBA and IBA

Furthermore, the Government announced the removal of the time limit for claiming annual allowances on commercial and industrial buildings or structures starting from the year of assessment 2024/25. This change addresses the current disparity in tax treatment between buyers of commercial or industrial properties with similar capital expenditures, ultimately fostering a more business-friendly environment.

Presently, claims for annual allowances for a commercial or industrial building or structure are subject to a maximum limit of 25 years or 50 years, beginning from the year of assessment in which the building or structure was first used ("usage period"). If a commercial or industrial building is sold before the end of the usage period, the seller will be subject to a balancing adjustment, while the buyer will be able to claim annual allowances based on the residue of expenditure immediately after the sale over the remaining years within the usage period. Conversely, if the building or structure is sold after the end of the usage period, the seller will still be subject to a balancing adjustment, potentially recouping previously granted allowances if the adjustment results in a balancing charge. In this scenario, however, the buyer will not qualify for any annual allowance since the usage period has expired at the time of purchase.

The current time limit on claiming annual allowances results in unequal tax treatment for buyers of commercial and industrial properties with similar capital expenditures before and after the end of the usage period. This disparity may discourage the purchase of old or second-hand properties. To address these issues, the Financial Secretary announced in the 2024-25 Budget the Government's plan to amend the IRO to remove the time limit for claiming annual allowances for commercial and industrial buildings, effective from the year of assessment 2024/25. The key provisions under the amended IRO are as follows:-

(a) If a commercial or industrial building or structure with an unexpired usage period is acquired and used by the buyer during the basis period for a year of assessment prior to 2024/25, the buyer will be entitled to an annual allowance calculated according to the existing provisions of the IRO.
(b) If (i) a buyer acquired an industrial building or structure before the commencement of the basis period for the year of assessment 2024/25 but was not granted any annual allowance because the usage period had expired at the time of acquiring the property; or (ii) a commercial or industrial building or structure (regardless of whether the usage period has expired) is acquired and used by the buyer in the basis period for a year of assessment starting on or after 1 April 2024, an annual allowance of 4% on the remaining expenditure immediately after the sale will be granted to the buyer starting from the year of assessment 2024/25 and can be claimed until the entire residue of expenditure has been fully claimed.
(c) In any of the scenarios outlined in paragraphs (a) and (b), the seller will continue to be subject to a balancing adjustment in accordance with the existing provisions of the IRO.

Conclusion

The proposed tax initiatives announced in the 2024-25 Budget are designed to largely benefit taxpayers. Firstly, the introduction of a tax deduction for reinstatement costs on leased premises will alleviate the financial burden on businesses that frequently relocate or renovate their operating spaces. Taxpayers will be able to deduct these reinstatement costs from their taxable income, provided they meet specific criteria, thereby enhancing cash flow and supporting operational flexibility.

Secondly, the removal of the time limit for claiming annual allowances on commercial and industrial buildings or structures will create a more equitable tax environment. This change addresses existing disparities that can deter the acquisition of older properties by allowing buyers to claim a 4% annual allowance on the residue of expenditure immediately after purchase, regardless of whether the usage period has expired.

Overall, the proposed amendments aim to foster a more business-friendly environment, encouraging investments and supporting enterprises in managing their property-related expenses effectively. However, further guidance from the IRD would be welcome to provide additional clarity on the conditions to be met in order to qualify for the deduction of lease reinstatement costs, particularly in cases where a lessee’s obligation to reinstate the lease premises is not explicitly outlined in the lease agreement. On a different note, since deductions are permitted only for actual reinstatement costs and not for accounting provisions, taxpayers may need to consider the potential deferred tax implications.

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