



Hong Kong Tax Newsflash

Draft legislation on enhancement measures for lease reinstatement costs and commercial/industrial building allowances gazetted

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The Bill¹, which seeks to implement two enhancement measures for the deduction of expenses under profits tax as outlined in the 2024-25 Budget², was gazetted on 18 October 2024. The enhancement measures include a new tax deduction for lease reinstatement costs and the removal of the time limit for claiming Commercial Building Allowance (CBA) and Industrial Building Allowance (IBA). These measures are expected to alleviate the tax burden on businesses, foster a business-friendly environment, and enhance the competitiveness of Hong Kong's profits tax system. The Bill is scheduled for its first reading in the Legislative Council on 30 October 2024.

[Tax deduction for lease reinstatement costs](#)

Background

It is a common practice that tenants are obliged to reinstate the leased premises to their original condition at the end of the lease. Currently, lease reinstatement costs are regarded as capital in nature and are therefore non-deductible for profits tax purpose. Nevertheless, these costs are effectively ordinary business expenses that must be incurred

for leasing premises. As such, the government considers it justified to allow tax deductions for lease reinstatement costs.

Proposed measure

It is proposed that lease reinstatement costs would be deductible, subject to the following conditions:

- 1) The person claiming the deduction is a lessee of the lease;
 - 2) The lessee has an obligation, whether express or implied, arising from the lease or another agreement with the lessor, to reinstate or pay (whether in full or in part) for the reinstatement of the premises to their original condition at the end of the lease term or on early termination of the lease;
 - 3) The reinstatement costs have been incurred (i.e. they are not provisions made under accounting standards); and
 - 4) The amount of the reinstatement costs is reasonable³.
- Payments made by the lessee to the lessor for discharging the lessee's obligation to reinstate the leased premises would also qualify for a tax deduction.
 - There is no restriction on the types of premises (residential or commercial), as long as they are used in the production of the chargeable profits (e.g. residential premises for use as staff quarters).

The new deduction for lease reinstatement costs will become effective from the year of assessment (YA) beginning on or after 1 April 2024 (i.e. YA 2024/25).

Our observation

This measure would alleviate the tax burden on businesses and improve the business environment, thereby enhancing the competitiveness of Hong Kong's profits tax system. Notably, Hong Kong's proposed tax deduction for lease reinstatement costs is more flexible than that of its neighbouring jurisdiction Singapore, which only allows reinstatement costs that are contractually provided for in the lease agreements. In contrast, Hong Kong would provide tax deduction even under verbal agreements. Furthermore, unlike Singapore, there is no requirement in Hong Kong that the premises must not be vacated due to cessation of business. We are pleased that the Hong Kong SAR government seeks to introduce a more competitive and taxpayer friendly tax measure.

Removal of time limit for claiming CBA / IBA

Current issue

Currently, there is a usage time limit (generally 25 years⁴) for claiming annual allowances for a second-hand commercial or industrial building or structure (CBA / IBA), which begins from the YA in which a building is first used. If a commercial / industrial building is sold after the usage period, the buyer will not be entitled to claim any CBA / IBA while the seller will be subject to a balancing adjustment (i.e. effectively a claw-back of the CBA / IBA previously claimed). In other words, no capital

expenditures could be deducted for purchasing a commercial / industrial building that has been in use for more than 25 years. This creates a disparity in tax treatment for buyers of commercial / industrial buildings who incur the same amount of capital expenditure before and after the usage period.

Proposed amendment

It is proposed to remove the time limit for claiming annual allowances in respect of a commercial / industrial building, as follows:

- (i) If a taxpayer acquired an industrial building or structure before the YA 2024/25 but was not granted any annual allowance because the usage period had expired at the time of acquiring the building or structure; or
- (ii) If a commercial or industrial building or structure (whether the usage period has expired) is acquired and used by the buyer in or after the YA 2024/25,

an annual allowance of 4% on the residue of expenditure immediately after the sale will be granted to the buyer starting from the YA 2024/25 onwards, until the residue of expenditure immediately after the sale has been fully claimed.

We summarize the tax treatment under different scenarios after the amendment below:

Industrial building or structure

Acquisition year	Has the usage period expired?	Annual allowance
Before YA 2024/25	No	Residue of expenditure ⁵ over the remaining YAs of the usage period
	Yes	4% of residue of expenditure starting from YA 2024/25
In or after YA 2024/25	N/A [#]	4% of residue of expenditure

Commercial buildings or structure

Acquisition year	Annual allowance
Before YA 2024/25 [#]	Residue of expenditure over the remaining YAs of the usage period
In or after YA 2024/25 [#]	4% of residue of expenditure

[#] regardless of whether the usage period has expired

Implications

The proposed amendment would remove the disparity in tax treatment by allowing buyers to claim the capital expenditure incurred on the construction of a commercial / industrial building or structure in general. On the other hand, the balancing adjustment to the seller remains the same in accordance with the existing provisions under the Inland Revenue Ordinance.

The amendment would not affect newly constructed buildings or structures because the annual allowance for these is based on 4% of the construction cost, not the formula with time limit, according to the existing provisions.

Below are some examples illustrating buyers' entitlement to annual allowances in respect of the commercial / industrial building or structure post-amendment:

Example 1: Purchase of a second-hand commercial / industrial building in YA 2024/25 or after

The buyer would be entitled to an annual allowance of 4% on the residue of expenditure immediately after the sale, regardless of whether the usage period has lapsed.

Example 2: Purchase of a second-hand industrial building (first used in 1980) in YA 2020/21 (when the 25-year usage period has expired)

The buyer was unable to claim any allowance from YA 2020/21 to YA 2023/24 as the 25-year usage period had expired. Starting from YA 2024/25, the buyer would be entitled to an annual allowance of 4% on the residue of expenditure immediately after the sale (i.e. in 2020/21) until fully claimed.

Example 3: Existing second-hand commercial building (first used in YA 1998/99) that was purchased in YA 2020/21

The buyer should continue to claim annual allowances on the residue of expenditure over the remaining 4 years of the 25-year time limit (YA 2020/21 to YA 2023/24). No annual allowance would be claimed from YA 2024/25 onwards as the residue of expenditure has been reduced to zero after YA 2023/24.

Our observation

With advancements in construction technology, it is not unusual for buildings to remain in good condition and still in use beyond 25 years. Consequently, the market for second-hand industrial and commercial buildings beyond 25 years remains active.

The existing tax provisions for CBA / IBA, with a time limit on claiming allowances, no longer keep pace with the current business environment. We welcome the proposed amendment which can fix the issue in time. Amending these provisions is crucial to avoid discouraging buyers from purchasing old or second-hand buildings or structures for business use.

¹ [The Inland Revenue \(Amendment\) \(Tax Deductions for Leased Premises Reinstatement and Allowances for Buildings and Structures\) Bill 2024](#)

² Please see our [Hong Kong Tax Analysis – Issue H115/2024](#) and [Hong Kong Tax Newsflash – Issue 220](#) for details.

³ In determining whether the reinstatement costs are "reasonable", the Inland Revenue Department will consider the facts and circumstances of each case. The reinstatement costs are considered "reasonable" if they are made in accordance with the arm's length principle and would not significantly deviate from the market rates for reinstating similar leased premises.

⁴ 50-year time limit for industrial building first used before the year of assessment 1965/66

⁵ "Residue of expenditure" refers to the amount of capital expenditure incurred on the construction of the commercial / industrial building or structure, reduced by the amount of any initial allowance, annual allowance and/or balancing allowance granted, and increased by any balancing charge made.

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