Tax policy and budget proposals
2025-26

Building a sustainable future – fiscal stability, and economic and social development

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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Table of content

Theme I – Driving economic growth and attracting investment to Hong Kong

(1) Attract investment and foster Hong Kong's business friendly environment

a) Support for business:

- ➢ Two-tier profits tax rate regime: Adjust the rate downwards or raise the threshold of HK$2 million to, say, HK$4 million for small and medium-sized enterprises ("SMEs").
- ➢ Regional headquarters ("RHQ") economy: Offer a 50% profits tax concession for relevant profits derived by qualifying RHQs.
- ➢ Provide subsidies for consultancy and legal fees to companies re-domiciling to Hong Kong and ensure that the tax position of re-domiciled companies is clear and certain.
- ➢ Entrepreneurship: Provide tax concessions for company setting-up expenses, including capital expenditure, capped at HK$10,000, for standalone startups.
- ➢ Support SMEs in their digital transformation: Subsidize time-limited information technology ("IT") support (e.g., up to 36 months). This may include, e.g.:
  - Engaging a professional accountant to help upgrade their accounting systems in readiness for the mandatory tax e-filing regime.
  - Upgrading systems and equipment, to improve their productivity and, potentially, allow for some remote working.

b) Increase tax certainty:

- ➢ Continue to expand the network of double taxation agreements with major and emerging trading partners.
- ➢ Engage stakeholders as early as possible to provide practical feedback on proposed major tax law changes (e.g., implementation of the Base Erosion and Profit Shifting initiative ("BEPS") 2.0, Global Anti-Base Erosion Model Rules), allow sufficient transition time for taxpayers to get prepared and provide suitable guidance and support.
- ➢ Ensure a smooth introduction and user-friendly interface for the e-filing of profits tax returns:
  - o Continue to collect feedback from the market and practitioners on the design and operation of the e-filing system.
  - o Provide early adopters of e-filing with incentives, such as an extension of the tax filing deadline, early tax refunds, or additional tax rebates.
  - o Leverage on the efficiencies and data collected from e-filing to enhance tax administration and services for taxpayers, by, for example:
    - reducing the limitation period from six years to three or four years;
    - according statements of losses the same status as a notice of assessment;
- ➢ The Inland Revenue Department should strengthen tax audit capabilities, and commit, through performance pledges, to specific, shortened timeframes to review dispute cases and finalize tax positions.
- ➢ Review the first-level tax appeals system.

(2) Reinvigorate Hong Kong's sense of community, international branding, and revitalize the local retail and tourism economy and property market:

- Consider what defines and distinguishes the unique "Brand HK" and be prepared to promote and leverage on our strengths in different ways, which could involve a lighter touch approach to promotion; and commit to an investment-friendly environment:
  - ➢ Commit to maintaining Hong Kong's open markets the free flow of capital and information, and the integrity of the financial, legal and judicial systems.
  - ➢ Review Hong Kong's investment promotion strategies and policies – explore non-tax incentives.
  - ➢ Strengthen standards of Putonghua and English to help HK to fulfil its role as a "super-connector", bridging the Mainland and global markets, and to support a diverse community.
- Enhance market confidence:
  - ➢ Continue to put in place various measures to showcase Hong Kong's appeal to people from around the world. Promote Hong Kong's strengths as a diverse community, where people from all backgrounds can thrive and succeed.
  - ➢ Establish an expert group/ task force on the economy to examine and make recommendations on the challenges faced by the local businesses in retail, food and beverage, and tourism sectors, etc., given (i) the increasing convenience of cross-boundary travel and (ii) Hong Kong's higher cost base than that of Shenzhen and the Greater Bay Area ("GBA").

- Take active steps to incentivize more local spending, including promotion campaigns and offers and reward schemes for local citizens.
- Review tourism strategies to promote higher-end and eco-tourism. Work with the tourism boards of other GBA cities to promote combined Hong Kong and GBA tours and experiences for overseas tourists highlighting the distinct experiences of the different cities.
- Continue to encourage and support the holding of international arts, culture, and sports events and exchanges in Hong Kong, as well as fostering the development of a vibrant and diverse local arts and cultural scene. Revisit the tax treatment of non-resident entertainers and sportsmen.
- Leverage on Hong Kong's Olympic and post-Olympic successes to encourage more private sector sponsorship for potential elite sports and athletes, help develop a stronger sense of community locally, encourage the development of a wider sports culture and promote Hong Kong's image.
- Consider providing enhanced deductions for private sector donations made to "M" Mark events or certain sports institutes conducting designated/ elite sports training courses.

- Support the property market and home buyers:
  - For a limited period, say five years, allow purchasers of residential property for self-use, to pay the stamp duty, in equal annual instalments over a 3-year period from the original stamp duty due date.
  - If further stimulus to the property market is desirable, consider reducing stamp duty (e.g., by 50% for property values or consideration up to, say, HK$12 million) for first time buyers of self-use residential properties, over the next three years.

(3) Support for research and development ("R&D"), innovation and technology ("I&T") and intellectual property ("IP") business

- Government should work with different sectors to promote and advocate the new patent box regime to businesses.
- Conduct a more extensive review of tax incentives for R&D, I&T and IP creation and development and also explore other non-tax incentives, including those offered overseas. For example:
  - introduce a simplified form of group loss relief for R&D activities by election, allowing groups to designate a particular company's R&D-related losses to offset against profit;
  - consider R&D tax credits for start-up businesses, particularly in strategic sectors, such as I&T and green industries, and consider BEPS-compliant "Qualified Refundable Tax Credits", where appropriate;
  - modify the enhanced R&D and IP tax deduction rules and extend their coverage to accommodate the real commercial practices of businesses engaged in these activities (e.g., allow deductions for the costs of acquiring IP from associates, IP licensed to other persons for use outside Hong Kong, and for the costs of outsourced, arm's length, R&D activities);
  - consider non-tax support, including financial subsidies, to encourage more local R&D activity.

(4) Streamline and update aspects of Hong Kong's business laws and regulations

- Keep business licensing arrangements under review and streamline and digitalize them, where possible, and review corporate bank account opening procedures.
- Introduce a corporate rescue regime or explore alternatives, such as allowing provisional liquidation under Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) to be used for restructuring.
- Provide for virtual creditors' and other insolvency meetings.

Theme II – Attracting, developing and retaining talent in Hong Kong

(1) Measures to address the talent gap

- Attract and retain talent:
  - Provide time-limited subsidies or tax concessions, e.g., double deductions, to targeted industries facing talent shortages so that employers can offer more competitive salaries.
  - Enhance talent mobility: Connecting Hong Kong to the GBA and global markets, including simplifying the visa application procedures, and opening a green channel for GBA and foreign students to come to Hong Kong for internships in the accounting and other sectors, during the peak seasons.
- Encourage child birth and attract overseas talent to raise their families in Hong Kong:
  - Consider doubling the personal allowances under salaries tax of parents with newborn babies, for the first two years after the child's birth.
  - Encourage businesses to allow working from home ("WFH")/ hybrid working for employees in the first one or two years after the birth of their children and to implement other family-friendly

policies, such as flexible working arrangements, part-time work and also creating suitable spaces for breastfeeding on site.
    - Provide an allowance for the private education of the children of overseas talent, up to a certain limit annually.
- Retain and develop the skills of the workforce:
    - To encourage local talent and experience back to the workforce, in addition to incentives for new parents (see above), offer double the basic salaries tax allowances to retired individuals aged 65 and above, for two years.
    - Encourage more family-friendly policies, e.g., WFH/ hybrid working, seasonal employment and flexible retirement arrangements.
    - Expand the deduction for self-education expenditure to cover expenditure incurred by a taxpayer's dependants.
    - Subsidize employers to send employees on qualifying courses to upgrade their skills.
    - Offer targeted training programmes and career counselling services to support stay-at-home parents and seniors to update their skills, and give them opportunities to return to the workforce.
    - Government should take the lead in giving staff the option to defer their retirement age to 65 - 68 (for both civilian and, where practical, disciplined services officers); and encourage employers to hire and retain experienced older people in employment.
- Nurture talent in key areas for Hong Kong's future development, including R&D, I&T, sustainability and green finance:
    - Support STEAM (science, technology, engineering, the arts and mathematics) education, through "sandwich" courses, industry placements, scholarships, etc., and offer more specific support to universities and research institutions to provide specialized courses and hands-on training in R&D, I&T, sustainability and green finance.
    - Provide subsidies to cover part of the costs incurred by companies that wish to invite international experts to provide professional training to their Hong Kong R&D staff.
    - Extend or regularize the Pilot Green and Sustainable Finance Capacity Building Support Scheme to promote training to build up the local green and sustainable finance talent pool.
- Support leadership training:
    - Provide support for schools and universities to establish leadership training courses to develop the next generation of leaders who should have -
        - Strategic knowledge and vision
        - Awareness and understanding of the issues facing the community and society
        - Understanding of the importance of technology and other forces of change, including climate change, etc.

(2) Alleviate living cost of citizens
- Community support:
    - Provide a tax reduction of 100%, subject to a ceiling of HK$6,000, on salaries tax, tax under personal assessment and profits tax for 2024-25.
    - Provide a rates concession for properties owned by natural persons for three quarters, subject to a ceiling of HK$1,200 per quarter. Consider restricting the concession only to properties with a ratable value of, say, HK$200,000, or to standard-band properties under the new progressive rates system.
    - Grant an electricity charge subsidy of HK$1,000 to each residential and commercial electricity account, in conjunction with promoting energy conservation measures.
    - Consider expanding "qualifying tenancies" eligible for the rental deduction for salaries tax purposes, to cover rental of a serviced apartment by means of a licence.
    - Increase the maximum tax deduction for qualifying premiums paid under the Voluntary Health Insurance Scheme ("VHIS") to HK$12,000 per each insured person, and consider extending the scope of VHIS to other programmes, e.g., outpatient services.
    - Increase the maximum tax deduction for qualifying annuity premiums and voluntary mandatory provident fund contributions to HK$80,000.
- Provide a tax deduction for expenses on approved sports courses and activities for taxpayers and dependants, of up to HK$12,000 per person, to promote a more active and healthy lifestyle.
- Increase basic personal allowances at least in line with inflation.
- Review the allowances for dependants and ensure any future adjustments are made on a more transparent and consistent basis.

Theme III – Sustaining public finances
(1) Enhance government revenue • Conduct a more extensive review of Hong Kong's tax system ➢ Review the tax system for its competitiveness and ability to provide sufficient revenue for Hong Kong's future development needs. ➢ Review the effectiveness and competitiveness of the existing preferential tax regimes. • Consider imposing an infrastructure toll on all private and public ground transportation entering specified Hong Kong control points. • Review and adjust toll rates of road tunnels periodically, considering both public finance and the current state of the economy. • Provide an updated estimate on increase revenue derived from the implementation of the Hong Kong Minimum Top-up Tax. • Consider increasing the stamp duty on leases of residential properties. • Consider increasing the higher-tier standard rate for salaries tax from 16% to 16.5%. (2) Optimize public expenditure • Assess government spending regularly to identify areas where costs can be reduced, including streamlining operations, eliminating inefficiencies and, where feasible, increasing automation. • Prioritize public spending for impact: Focus spending on essential public services such as housing, healthcare, education, welfare and digitalization i.e., areas that provide the greatest benefit to the community and measures to stimulate economic growth. • Consider opportunities for public-private partnerships in funding major infrastructure development, and the expansion of toll systems as means of recovering the cost of public funding. • Continue to monitor the effectiveness of "M" Mark events scheme, evaluate the actual economic impact, and, if necessary, refine the arrangements.
Theme IV – Building a sustainable future
(1) General policies to promote sustainability in Hong Kong • Revisit the blueprints and roadmaps previously published in relation to Hong Kong's commitment to achieving carbon neutrality by 2050, establish effective interim targets and ensure Hong Kong is not falling behind. • Establish policies to support renewable energy targets and technologies, including supporting businesses to adopt more sustainable practices and environmental, social and governance ("ESG") standards. • Further explore the development and use of alternative energy in Hong Kong, such as green hydrogen, and facilities and plants for testing. • Ensure major new infrastructure projects incorporate sustainability goals in terms of planning, processes, materials and designs, etc. and that construction meets the highest quality and safety standards. • Develop a more coordinated set of policies on recycling. Consider incentives for downstream recycling, waste-to-resources/ energy infrastructure (e.g., subsidies on land costs and facilities); and explore and encourage activities such as the use of recycled building materials and second-life applications for electric vehicle ("EV") batteries. • Research into the social aspects, i.e. the "S" in "ESG" and consider establishing benchmarks for integrating social considerations into business practices. (2) Measures in specific areas **a) Electric vehicles and green public transport** • Extend the EV-charging at Home Subsidy Scheme, and streamline and expedite the approval process. Consider other options as well, such as providing a tax deduction for installation costs for EV home chargers. • Continue to offer first registration tax concessions for private car EVs. • Continue to encourage and support public transport operators to explore, test and adopt more widely, the application of green innovative transport technologies, e.g., hydrogen fuel cell EVs.

- Where there are currently no EV or new energy alternatives, adopt, as a minimum, the Euro VI emission standard for all commercial vehicles and consider further incentives for replacement of Euro IV and V vehicles.
- Legalize and support the use of electric mobility devices, including electric scooters.
- Support the setting up of battery swapping stations for e-motorcycles.
- Support the development and adoption of Battery-as-a-Service for EVs in Hong Kong.
- Develop policies on the recycling and reuse of EV batteries.

b) Green buildings

- Adopt best practice standards for energy-efficient buildings in Hong Kong and mandate some requirements. Introduce enhanced industrial and commercial building allowances for buildings that follow these standards (e.g., an initial allowance of 25% and an annual allowance of 5% for industrial buildings and, say, an annual allowance of 6.5% for commercial buildings).
- Incentivize the use of green building materials, including green cement, in construction.
- Encourage the adoption of the WELL label by educating stakeholders about the benefits.
- Incentivize owners of old residential buildings to renovate their buildings sustainably.
- Advocate the energy-efficient equipment subsidy schemes provided by HK Electric and CLP to encourage businesses in upgrading their premises with energy-efficient lighting and air-conditioning systems.

c) Energy efficiency

- Promote “replace old items with new ones” to the public – provide subsidies to consumers who trade in old appliances for specified energy-efficient appliances, e.g., air-conditioners, refrigerators, washing machines, televisions, etc., with Grade 1 energy label, and provide for the safe disposal of the old, traded-in items.

d) Green finance

- Following the publication of the Roadmap on Sustainability Disclosure in Hong Kong, the Government should consider encouraging large publicly accountable entities to voluntarily adopt ISSB Standards, or HKFRS Sustainability Disclosure Standards, which are fully aligned with ISSB Standards, before the mandatory 2028 deadline, by offering enhanced tax deductions on qualifying expenditures, including outsourcing costs and staff costs for sustainable finance professionals, etc.
- Foster the development of a more extensive framework for the adoption of ESG assurance.
- Extend the Pilot Green and Sustainable Finance Capacity Building Support Scheme for two years.
- As an interim measure, allow a deduction of the costs incurred on purchasing appropriately certified renewable energy and carbon credits, up to an appropriate ceiling.

Responding to the public consultation on the 2025-26 budget, the Hong Kong Institute of Certified Public Accountants ("the Institute") sets out below its recommendations for the 2025-26 budget.

Introduction

With the efforts made by the Government of the Hong Kong Special Administrative Region ("the Government") to improve the economy by adapting to changing global dynamics and enhancing local competitiveness, Hong Kong ("HK")'s economy continued to expand at a moderate pace, with 3.3% year-on-year growth in real gross domestic product ("GDP") in the second quarter of 2024 and 1.8% in the third quarter. The unemployment rate during the three-month period from September to November 2024 continued to be low, at 3.1%, indicating near full employment. While we expect that the economy will maintain moderate growth, various factors including geopolitical tensions and the global economic and interest rate outlook, may continue to create uncertainties. As regards inbound tourism and private consumption, the Central Government's various measures to facilitate cross-boundary travel will benefit HK, but the changes in the consumption patterns of visitors and residents and the relatively strong HK dollar will continue to pose challenges. Taking into account the actual outturn in the first three quarters of the year and the latest developments of the global and local situation, the Government has revised the real GDP growth forecast for 2024 as a whole to 2.5%, which is reasonable for a developed economy. The forecast rates of underlying and headline consumer price inflation for 2024 have been revised downwards to a very modest 1.1% and 1.7% respectively.

HK suffered large financial deficits in 2022-23 and 2023-24, of HK$122.3 billion and HK$100.2 billion, respectively. This led to a drop in the fiscal reserves to HK$734.5 billion, as at 31 March 2024, the lowest level since 2012-13. A further deficit of HK$48 billion was forecast in the 2024-25 budget for the current year and this is now expected to be significantly larger, and probably close to HK$100 billion, which has triggered discussions on whether the deficits are structural. However, HK has faced similar challenging situations in the past, when the same questions were asked, in particular after the Asian Financial Crisis and the spread of SARS virus. In that case, HK was able to demonstrate resilience and come through those times and emerge financially and spiritually stronger, so there is no reason to doubt that we can do so again, with prudent fiscal management and continuing measures to boost HK's competitiveness and develop the economy. The current circumstances, however, reinforce the importance of achieving long-term fiscal stability and sustainability, and continuing to look for additional sources of revenue and ways to control and optimize public expenditure, particularly recurrent expenditure. We acknowledge the Government's ongoing efforts in this regard.

The keen competition from other economies, coupled with other issues, including the need to attract more talent, the ageing population and low birth rate, has further amplified the challenges faced by HK. However, the Government has reported that, as at end-2024, over 430,000 applications had been received under various talent admission schemes, with over 270,000 applications approved. Over 180,000 talents have arrived in HK, exceeding the Government's target of attracting 105,000 talents over the three years from 2023 to 2025. These arrivals also bring their families to settle in HK, with about 170,000 dependants having arrived in HK so far, including nearly 100,000 dependent children under the age of 18[1]. This has, to some extent, helped to counter the impact of the talent shortage and migration. However, in the next five years, there will still be a projected shortage of around 180,000 workers across different sectors. Therefore, HK must continue to address issues related to talent attraction and retention. As

[1] https://www.info.gov.hk/gia/general/202501/15/P2025011500238.htm

regards attracting businesses, through the Office for Attracting Strategic Enterprises ("OASES"), which was set up by the Government in December 2022, a number of strategic enterprises have established or expanded their business in HK, and more will do so in the future. These strategic enterprises are pioneers in different innovation and technology ("I&T") fields, and they are expected to bring in over HK$40 billion in investment and over 13,000 job opportunities in the coming few years[2].

These are all positive initiatives, but further steps could still be taken to help secure a successful future for HK, by continuing to strengthen HK's position as an international financial and business centre ("IFC"), and its attractiveness to overseas investors, while appealing to local and overseas talent. We believe that HK needs to enhance its branding and demonstrate itself to be one of the best places in the world to live, work and visit. We should review our investment promotion strategies, tax policies and overall competitiveness, so as to retain and attract both investment and talent, and build on our strengths.

Among the many positive signs, HK has regained its place as the world's freest economy among 165 economies, in the Economic Freedom of the World 2024 Annual Report published by the Fraser Institute in October 2024[3]. The city ranked third globally, and first in the Asia-Pacific region, in the Global Financial Centres Index 36 ("GFCI") Report, published in September 2024. The overall rating increased by eight points, the largest improvement among the top five financial centres[4]. HK also rose significantly in the World Talent Ranking published in September by the International Institute for Management Development ("IMD"), moving up to ninth, from 16 last year, and returning to the top 10 for the first time since 2016[5].

Against the above backdrop, the Institute's budget proposals 2025-26, put forward a wide range of possible measures under four main themes, aimed at helping HK to continue to grow, while enhancing its innovation and resilience. Our recommendations encompass measures to stimulate investment, attract and retain talent, foster innovation, and promote sustainability. While certain proposals may mean forgoing some revenue in the short term, the ultimate objective is to attract more investment, including investment in I&T, and in research and development ("R&D") and intellectual property ("IP")-related businesses, and so boost the economy, which will in turn generate more tax revenue. Implementing these initiatives, we believe can help HK overcome challenges, promote high-quality development and establish an environment conducive to sustainable growth and prosperity. We believe that, in the present economic environment, there are also strong grounds for taking a step back and looking at the competitiveness of our tax system as a whole, as well as considering non-tax incentives for investment.

Clearly, there is also a need to monitor and control expenditure and save costs, where possible and practicable, without adversely affecting the most disadvantaged in the community. As recurrent expenditure in 2024-24 is estimated to take up over 90% of government revenue during the same period, it is evident that control over increases in recurrent expenditure is key. Some reallocation of resources and adjustment of priorities should be considered, while also continuing to explore new sources of revenue.

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[2] https://www.budget.gov.hk/2024/eng/speech.html (see paragraph 32)

[3] https://www.info.gov.hk/gia/general/202410/16/P2024101600606.htm?_cldee=Oic2KgCSe3kRHVEHj_WpUlwH5FAJrk78oLTBWwUaONTTXUKKX9a4AfC-XU0nDva6&recipientid=contact-db7c631303a6ec11b81c0050568d1b3e-dcd51595692f47cb824d5efcd815f31b&esid=b6665f59-4d9a-ef11-b826-0050568d4f85

[4] https://www.info.gov.hk/gia/general/202409/24/P2024092400300.htm

[5] https://www.info.gov.hk/gia/general/202409/19/P2024091900285.htm

To help Hong Kong write a new chapter and re-establish itself as one of the best places in the world to live, work and visit, the Institute is pleased to put forward its 2025-26 budget proposals, under the title of "*Building a sustainable future – fiscal stability, and economic and social development*". The proposals are grouped under four main themes, with several subthemes, each containing a number of more detailed recommendations, as set out below.

Theme I: Driving economic growth and attracting investment to Hong Kong

Overview

In the latest IMD World Competitiveness Yearbook 2024[6], published in June 2024, HK's ranking improved by two places to fifth globally (behind Singapore, Switzerland, Denmark and Ireland). Among the four competitiveness factors, HK's rankings in business efficiency and infrastructure rose notably and came within the top 10 globally. The ranking in government efficiency stayed high among the top three and the ranking in economic performance also saw significant improvement, reflecting the economic recovery in 2023.

In a similar vein, in the World Bank Group's first Business Ready 2024 Report[7], published in October 2024, HK came out among the top ten performers overall among 50 economies covered in the report. The report compares the overall performance of economies in terms of their business environment under ten topics and three pillars[8]. HK ranked first in the International Trade and third in Taxation. Other topics where HK scored highly included "Business Entry" and "Utility Services". Among the three pillars, HK ranked fifth in "Operational Efficiency".

It is clear that HK is moving in the right direction and should maintain efforts to promote and reinforce its traditional competitive advantages, including a business-friendly environment, sound legal system, free flow of capital and information, advantageous geographical location, wealth of experience as a "super connector" between the Mainland and overseas jurisdictions, as well as its long-standing status and reputation as an IFC. We need to ensure that supportive policies are in place, to attract investment from new markets, while making strong efforts to maintain our traditional markets and adopt a more innovative mindset. Reinforcing tax certainty in HK is also crucial if we are to continue to attract multinational enterprises ("MNEs") and maintain our status as a top destination for international business.

In the meantime, we should examine the challenges faced by different sectors given the increasing convenience of cross-boundary travel and HK's much higher cost base than the Greater Bay Area ("GBA")'s generally, and take active steps to incentivize more local spending.

One of the roles envisaged for Hong Kong under the 14th National Five-Year Plan ("14th FYP") is an IP trading hub. We welcome the recently-introduced patent box tax incentive, which reduced the tax rate for qualifying profits derived from patents, and certain other related IP, from the existing 16.5% to 5%, and suggest that additional steps should be taken to encourage more R&D activities, and to support the transformation and commercialization of the output.

HK's journey to becoming a smart city should involve not only initiatives for digital government but also the digital transformation of enterprises, including small and medium-sized enterprises ("SMEs"). Digital transformation will enable SMEs to adapt to changing market dynamics, enhance operational efficiency, cope better with the shortage of talent, and stay competitive. Ongoing support is necessary to facilitate this transformation, through, e.g., funding for hiring IT specialists, to facilitate SMEs' digitalization.

We note and welcome the fact that the Chief Executive's 2024 Policy Address ("PA") touched on a number of the above issues, and we suggest further measures to support policies in

[6] https://www.imd.org/wp-content/uploads/2024/06/WCY_Bookletv1_2024-1.pdf
[7] https://www.worldbank.org/en/businessready
[8] The ten topics are "Business Entry", "Business Location", "Utility Services", "Labor", "Financial Services", "International Trade", "Taxation", "Dispute Resolution", "Market Competition" and "Business Insolvency". The three pillars include Including "Regulatory Framework", "Public Services" and "Operational Efficiency".

these areas.

Proposals

While, currently, HK's overall economic situation is steady, changes in the domestic and external environments, as well as fluctuations in the economic cycle, have brought about some difficulties and challenges. Among the three key drivers of HK's economy, for the first nine months of 2024 as a whole, the total exports of goods grew by 4% year-on-year in real terms, and investment expenditure rose by 3.7% in the third quarter. Yet, factors such as changes in the consumption patterns of visitors and HK residents, as well as the strength of the HK dollar, have put pressure on private consumption[9].

The Government is trying vigorously to attract business, capital and talent from around the world to come to HK, driving the further development of key sectors where HK enjoys an edge, including financial services, I&T, and trade, and embracing green transformation and the digital economy. We support the Government's efforts to set out clear objectives for HK's future economic development and we believe that it is important introduce a range of associated policies that are consistent with and support those objectives.

Against this background, we propose below a range of measures to help strengthen HK's competitiveness in attracting foreign investment and talent.

(1) <u>Attract investment and foster Hong Kong's business friendly environment</u>

a) Support for business

Review the two-tiered profits tax rate regime

A two-tier profits tax rates regime was introduced in 2018-19 to lower the tax rate to 8.25% for the first HK$2 million of assessable profits for corporations and unincorporated businesses. After six years of implementation and considering the relatively slow pace of the economy recovery, in order to improve the cash flow of local businesses, we suggest that the effectiveness of the regime be reviewed and consideration given to adjusting the rate downwards or raising the threshold of $2 million to a higher level, say, HK$4 million, specifically for standalone SMEs.

<u>Proposal</u>
Review the effectiveness of the two-tier profits tax rate regime and consider adjusting the rate downwards or raising the threshold of HK$2 million to a higher level, say, HK$4 million, for standalone SMEs.

Regional headquarters ("RHQs") and companies re-domiciling to Hong Kong

While HK is a leading IFC and regional business hub, Singapore has historically been a preferred location for multinational companies' RHQs in Asia, especially for those in the technology sector[10]. This may be attributable partly to the favourable tax incentives that Singapore offers to approved HQs, which can enjoy a lower corporate income tax rate of 5% to 15% on qualifying activities, and 8% for corporate treasury centres, for intra-group financing activities. In contrast, HK does not offer

[9] https://www.hkeconomy.gov.hk/en/pdf/24q3_pr.pdf
[10] https://www.legco.gov.hk/research-publications/english/1920issh27-foreign-mainland-companies-setting-up-offices-in-hong-kong-20200605-e.pdf

a concessionary tax rate for RHQs, and corporate treasury centres are taxed at 8.25% under the preferential regime introduced in 2016.

In the 2024 PA[11], the HK Chief Executive spoke of promoting development of a headquarters economy, including by introducing a mechanism for company re-domiciliation. We welcome the Government's commitment to strengthening HK's position as an HQ economy, which will help consolidate its status as a global hub for finance, transportation, trade and aviation, thereby attracting more new funds, new technologies and talent. To further encourage MNEs to establish RHQs here, we recommend the introduction of a more specific profits tax concession for RHQs.

Financial Services and the Treasury Bureau ("FSTB") conducted a public consultation[12] in 2023 on the introduction of a company re-domiciliation regime to provide a simple and straightforward route for foreign-incorporated companies to change their domicile to HK, whilst maintaining their legal identity and continuity, and minimizing the disruption to their business operations. The Institute responded to the consultation[13].Taking into account the feedback received, FSTB released the consultation conclusion[14] and legislative proposals in early July 2024. The proposed re-domiciliation regime aligns well with recent international business and tax developments and offers an attractive option for business restructuring in HK going forward. We urge the Government to ensure that the status and tax position of re-domiciled companies is clear, certain and straightforward.

Any preferential treatment for RHQs would need to be consistent with the rules under the Base Erosion and Profit Shifting initiative ("BEPS") 2.0 Pillar 2. This requires jurisdictions that have joined the BEPS Inclusive Framework, including HK, to apply a global minimum effective tax rate of 15% on MNEs with a consolidated income of at least 750 million euros ("the GloBE Rules"); and the Government has recently introduced legislation into the Legislative Council ("LegCo") to give effect to the GloBE Rules in HK. Given this changing tax landscape, particularly for large MNEs, we propose that the Government should also consider providing some non-tax incentives, such as subsidies to qualifying RHQs and/or re-domiciled companies to hire or relocate high-quality talent, and/or for the rental costs of expatriate staff. Furthermore, pending the enactment of the proposed re-domiciliation regime, the Government may consider providing subsidies for consultancy and legal fees to companies re-domiciling to HK, in order to alleviate the financial costs associated with the re-domiciliation process and foster a more competitive business environment.

Proposals

- ***Consider offering a 50% profits tax concession (i.e., a rate of 8.25%) for relevant profits derived by qualifying regional headquarters.***
- ***Ensure that the standing and tax position of re-domiciled companies is clear, certain and straightforward.***
- ***Consider other possible non-tax incentives, including subsidies for consultancy and legal fees to companies re-domiciling to HK.***

Supporting small- and medium-sized enterprises ("SMEs")

There are over 360,000 SMEs in HK, constituting more than 98% of businesses and employing about 45% of the workforce in the private sector. It is expected that more SMEs will need to undergo digitalization in the coming years to ensure the sustainability of their businesses. They

[11] https://www.policyaddress.gov.hk/2024/public/pdf/policy/policy-full_en.pdf
[12] https://www.fstb.gov.hk/fsb/en/publication/consult/doc/Public%20consultation%20paper%20(e)_for%20issue.pdf
[13] https://www.hkicpa.org.hk/-/media/Document/APD/TF/submission/TFEC_proposed-re-dom-regime_submission_230531.pdf
[14] https://www.fstb.gov.hk/fsb/en/publication/consult/doc/ConsultationConclusionOnCompanyRe-domiciliationRegime_e.pdf

will also be asked to play their part in HK's transformation to a carbon neutral economy in the longer term and, in this regard, digitalization can help them move away from paper-based processes and operate more sustainably. Following the Government's Smart City initiative, set out in the second edition of Hong Kong's Smart City Blueprint[15], the deployment of secured cloud services, big data and artificial intelligence ("AI") should also be encouraged.

We welcome the Government's measures in the 2024 PA to support SMEs during the economic transition, such as the expansion of the Cyberport's Digital Transformation Support Pilot Programme[16] (para. 134(iii)). While there are a number IT support schemes that aim to assist SMEs, they tend to provide one-off project-based subsidies, whereas SMEs may also need ongoing digitalization support.

Apart from seeking non-local talent, SMEs may also consider outsourcing vendors or using IT to replace some manual tasks. Given their limited resources, we suggest that consideration be given to providing further support to SMEs, through a time-limited incentive (e.g., up to 36 months) in the form of a subsidy or tax super-deduction to hire an IT specialist to facilitate their general digital transformation. Qualifying types of support should include, inter alia, engaging a professional accountant to help them upgrade their accounting systems in readiness for the implementation of a mandatory electronic tax filing ("e-filing") system, which is currently under development by the Inland Revenue Department ("IRD"). The proposed funding should also be sufficiently flexible to be usable by SME proprietors to upskill their employees' or their own skill sets to improve their IT capabilities. An arrangement could be put in place along the lines of the Research Talent Hub for Innovation and Technology Fund projects[17] under the Innovation and Technology Commission, with an emphasis on engaging more experienced IT (post) graduates and specialists.

In practice, flexible working arrangements that allow employees to work remotely could also help companies hire overseas talent without necessarily requiring them to work in HK. Given the current shortage of IT professionals in HK, this could also offer a partial solution for companies and may even allow departing local professionals to continue to do work for their existing employers in some cases. However, smaller organizations may not be able to afford the costs of new hardware, networks and technologies, including cyber security safeguards, to support employees working remotely. Therefore, support could be offered to SMEs to (i) upgrade systems and equipment, (ii) provide technical and infrastructure support (including computers, software, Wi-Fi networks, etc.) to remote working employees, including young parents working from home ("WFH") (see also Theme II below).

Supporting entrepreneurship

In addition to the Funding Scheme for Youth Entrepreneurship in the GBA mentioned in the 2024 PA (para. 65), we suggest that support be offered for entrepreneurship in HK more generally, by providing a tax concession for some of the setting-up expenses incurred by standalone startups. This can help send a signal to young people, among others, that the community supports their efforts to develop their business and leadership skills by setting up their own companies.

To support entrepreneurships and SMEs and enhance the overall digital transformation in the business community, we recommend considering the following measures:

[15] https://www.smartcity.gov.hk/modules/custom/custom_global_js_css/assets/files/HKSmartCityBlueprint(ENG)v2.pdf
[16] https://www.news.gov.hk/eng/2024/08/20240830/20240830_154540_647.html?type=category&name=finance
[17] https://www.itf.gov.hk/en/funding-programmes/nurturing-talent/research-talent-hub/research-talent-hub-for-itf-projects-rth-itf-/index.html

Proposals

- ***Provide tax concessions for company formation/ setting-up expenses, including capital expenditure, capped at HK$10,000, for standalone startups, (i.e. those not part of an existing group).***
- ***Support SMEs in their digital transformation: Subsidize time-limited information technology support (e.g., up to 36 months). This may include, e.g.:***
  - ❖ ***Engaging a professional accountant to help upgrade their accounting systems in readiness for the mandatory tax e-filing regime***
  - ❖ ***Upgrading systems and equipment, to improve their productivity and, potentially, allow for some remote working.***

b) Increase tax certainty

Expand network of double taxation agreements

While the Government has been steadily expanding HK's network of comprehensive avoidance of double taxation agreements ("CDTAs"), continued efforts should be made to increase the number of CDTAs. These efforts should include seeking to negotiate with major trading partners and countries with which HK has an emerging trade relationship, including Australia and the United States ("US"), as well as members of the Association of Southeast Asian Nations, Belt and Road and Middle Eastern countries.

In addition to a low-rate and relatively simple tax regime, certainty of tax treatment has been another important factor of the tax system affecting the overall attractiveness of HK as a place of investment for MNEs. However, there have been numerous changes to HK's tax regime in recent years, often brought about by international developments, such as the BEPS initiative, and the call by the European Union ("EU") for a review of HK's foreign-sourced income exemption ("FSIE") regime for passive income, to address aspects of it that could be open to abuse and result in "double non-taxation". These developments have created uncertainties, particularly for MNEs, and consultations on the implementation of such proposals have tended to come at a late stage when there is little room left for change. Sometimes certain important questions can remain unresolved.

We appreciate the opportunities afforded representatives of the Institute's Taxation Faculty to meet FSTB and the IRD to discuss some of the recent changes and we welcome the efforts made by the Government to gather views from stakeholders on the FSIE regime and, more recently, BEPS. We see ongoing dialogues of this kind, at the earliest stage practicable, as being vital, and we would urge that the taxpaying community be involved during the early phase of future significant legislative proposals, so that stakeholders can provide feedback on the real practical impact of the proposed changes. This, in turn, can help inform the discussions and negotiations conducted at the international level, where appropriate, and enable stakeholders to better prepare themselves for any changes that may need to be made.

In particular, as noted above, the legislation to implement the GloBE Rules, as well as a domestic minimum top-up tax ("DMTT") in HK has been introduced into LegCo and, following its passage through LegCo, will apply retrospectively from 1 January 2025. Sufficient transition time should be allowed for affected taxpayers to consider and get prepared for the changes that this legislation will bring about for some major taxpayers. The Government should also continue to seek further feedback on the implementation arrangements and issue, as early as possible, more guidance, including department interpretation and practice notes, where appropriate, to address practical issues and make clear how these changes will interact with the rest of the Inland Revenue Ordinance ("IRO").

Proposals

- ***Continue to expand HK's network of double taxation agreements, with major trading partners and countries with which HK has an emerging trade relationship.***
- ***Engage stakeholders early to provide practical feedback on proposed tax law changes and allow sufficient transition time for taxpayers to get prepared. Clarify how international tax laws, such as the BEPS 2.0 GloBE Rules, will interact with the existing tax framework and provide suitable guidance and support.***

Make good use of the e-filing system for taxation

<u>Gather feedback to enhance the user-friendliness of the system</u>

Since early 2021, the IRD has been undertaking a two-phase project on the e-filing of profits tax returns. In the first phase, the existing eTAX Portal has been gradually enhanced to enable more businesses to voluntarily file profits tax returns electronically, together with their financial statements and tax computations. In the second phase, a new Business Tax Portal will be developed by 2026 for the e-filing of profits tax returns, initially by large companies with the ultimate goal of achieving full-scale implementation of mandatory e-filing by 2030.

Any e-filing system needs to be user-friendly and compatible with the way business is conducted and how businesses and their professional advisers interact. We expect that the system should help to improve efficiencies and align HK with international best practices. With this objective in view, the Institute participated in consultations on the development of the e-filing system and also taken part in trial runs of aspects of the system during 2023 - 2024.

The IRD should continue to solicit feedback from the market and the profession on the design and operation of the system and improve and fine-tune the system as appropriate.

<u>Encourage early adopters by providing appropriate incentives</u>

To let corporations and businesses familiarize themselves with the tax e-filing requirements, which uses eXtensible Business Reporting Language ("iXBRL"), voluntary e-filing of profits tax returns, together with financial statements and tax computations in iXBRL format, was rolled out in April 2023. This gives taxpayers and practitioners the opportunity to familiarize themselves with the system, as well as the IRD's Taxonomy Package and the Preparation Tools, before the implementation of the initial phase of mandatory e-filing in 2026, and to reflect their experience of using the system to the IRD, as early as possible. However, we understand that the take up of voluntary e-filing has been slow, as taxpayers and tax representatives are not sufficiently incentivized to try using the system. Therefore, we would suggest that more incentives be offered, such as further extended filing deadlines, early tax refunds or additional tax rebates, to encourage taxpayers to use the e-filing system on a voluntary basis. This is in the interests of all parties, in order to ensure a smooth and effective transition to e-filing and the promotion of digitalization.

<u>Leverage the data collected through e-filing</u>

Wherever possible, the availability of data from e-filing should be leveraged to improve services and streamline the system for taxpayers and their representatives.

Upon the full adoption of mandatory e-filing of profits tax returns for businesses, all companies, including inactive and loss-making companies, will be required to perform annual tax filing or submit their accounts. With all the financial and accounting data collected in the system, less manual effort will be needed, and the IRD should be able to analyse tax data more efficiently.

Given the above, we would hope that, over time, the statutory limitation period for finalizing tax cases could be reduced to, say, three or four years after the end of a particular year of assessment. Again, this could be used as another incentive to adopt e-filing. Shortening the limitation period would also help speed up the collection of tax underpaid in field audit and tax investigation cases.

In addition, we suggest amending the tax law to give statements of loss the same status as notices of assessment. This will increase certainty for taxpayers and investors and reduce their compliance costs.

Proposals

- ***Ensure a smooth introduction and user-friendly interface for the e-filing of profits tax returns:***
  - ❖ ***Continue to collect feedback from the market and practitioners on the design and operation of the e-filing system.***
  - ❖ ***Provide early adopters of e-filing with incentives, such as an extension of the tax filing deadline, early tax refunds, or additional tax rebates.***
- ***Leverage on efficiencies and data collected from e-filing to enhance tax administration and services for taxpayers, by, for example:***
  - ❖ ***Reducing the limitation period from six years to three or four years***
  - ❖ ***According statements of losses the same status as a notice of assessment***

Improve the tax dispute and appeals system

Under the current HK tax legislation and regulatory framework, it can take considerably more than six years for taxpayers to settle field audit and tax investigation cases. Therefore, taxpayers may need to retain documents for many years to support their cases. Changes in employees or business owners may make it more difficult to provide supporting evidence, thereby disadvantaging taxpayers. Expediting the tax audit process and committing to a performance pledge on the timeframe for concluding field audit and investigation cases, would help taxpayers better manage their tax risks and exposures.

The current regime also provides that the Commissioner of Inland Revenue (“CIR”) is required to determine an objection filed by a taxpayer against an assessment within a “reasonable time”. It would be beneficial to taxpayers if there were a fixed timeframe for CIR to make a final decision. In recent years, tax practitioners also note that the processing time can vary significantly and some tax audit reviews have been long running, possibly due also to challenges posed during the pandemic.

We would also recommend reform of the penalty system, including the calculation of judgement debt interest and the interest rate on tax reserve certificates, to achieve a more equitable system.

Back in 2008, in the case of *ING Baring Securities (Hong Kong) Ltd v Commissioner of Inland Revenue*, the Court of Final Appeal questioned whether the existing structure of the Board of Review (“BoR”) properly facilitated the hearing of complex tax appeals and whether it was time to establish a full-time tribunal staffed by permanent members. In response to a request by the Government for views on the future of the BoR, and its role in the appeal procedures for taxation cases, the Institute issued a letter listing out various recommendations with the aim of enhancing the administration of justice. We note that the Joint Liaison Committee on

Taxation also issued a letter to the then Financial Secretary ("FS") on this matter in 2008. However, so far, it seems that no further steps have been taken to bring about reforms.

In view of the above, we believe that various measures should be implemented to improve the tax dispute and appeals system.

Proposals

- ***IRD should commit, through performance pledges, to specific, shortened timeframes to review dispute cases and finalize tax positions, specifically:***
  - ❖ ***Establish performance pledges on the timeframe for concluding field audit and investigation cases.***
  - ❖ ***Regarding the determination of objections by the Commissioner of Inland Revenue, amend the indefinite time limit of "reasonable time" with a fixed term of, say, one calendar year from the date Commissioner receives the objection.***
  - ❖ ***Establish key performance indicators on the time taken for the IRD to review dispute cases, e.g., 6 or 9 months.***
- ***Review and reform the penalty system, including the calculation of judgement debt interest and the interest rate on tax reserve certificates, which currently disadvantage taxpayers.***
- ***Review the first-level tax appeals system by benchmarking it against those of other advanced economies, and consider, for example:***
  - ❖ ***Introducing a two-tier tax tribunal, like the United Kingdom ("UK")'s, dividing simple and complex cases;***
  - ❖ ***the required experience and qualifications of the panel members, particularly for those dealing with complex cases;***
  - ❖ ***the panel structure and remuneration of panel members. Members should have sufficient time and expertise to review the case materials and draft decisions.***

(2) Reinvigorate Hong Kong's sense of community, international branding, and revitalize the local retail and tourism economy and property market

Promote the unique Hong Kong brand and commit to an investment-friendly environment

In view of the keen competition among global economies, added to the persisting negative perceptions of HK in various places around the world, we need to promote, consolidate and enhance HK's existing advantages, develop new edges and provide an all-round favourable business environment to attract overseas investment. In addition, it is important to review and monitor the effectiveness of HK's branding and communication strategies. We should consider what defines and distinguishes the unique "Brand HK" and be prepared to promote and leverage on our strengths in different ways, which could involve a lighter-touch approach to promotion rather than launching a big campaign.

Hong Kong's open markets and the integrity of the financial, legal and judicial systems

HK is an international city open to the world, underpinned by a capitalist system, with free flow of capital, people and information. It adopts a common law system, maintains its own legislative and judicial systems, laws, tax regime and currency and financial system. Inevitably, these cornerstones of HK society face pressures from time to time, but the Government should continue to safeguard them and give reassurances that they will continue to be core and permanent characteristics of HK.

Review investment promotion strategies and policies – explore non-tax incentives

Given the evolving international tax environment, referred to above, which will make it more difficult in future to rely extensively on tax incentives and a low tax regime to attract investment, especially from MNEs, there is a need to review HK's investment promotion strategies and policies. Consideration needs to be given to HK's positioning and to offering non-tax incentives and benefits, such as subsidies, that could be offered to boost HK's standing and reputation as a top-tier location for investment and place to live and work.

To this end, the Government should make use of a variety of channels and events to generate fresh, new and innovative ideas to attract business and investment. With the setting up of OASES and the Advisory Committee on Attracting Strategic Enterprises, representatives from the business sector and community leaders can provide advice to the Government on the overall approach to attracting strategic enterprises. To further enhance the effectiveness of such strategies, we suggest that the views of key stakeholders in different industry sectors be canvassed to ensure that the needs and priorities of these sectors are taken into account.

Strengthen language skills

According to a report issued by Education First on English Proficiency Index 2023[18], HK has "high proficiency" and is ranked 29th globally. However, it ranked 12th in 2011. There is a noticeable shift in the language landscape, indicating a reduction in English proficiency over time. Meanwhile, Singapore ranks significantly higher, in 2nd place, and Malaysia and the Philippines are also ranked above HK in terms of English proficiency. If this trend were to continue, it would affect HK's competitiveness as an international city.

English is an official language in HK and, in order to maintain our competitive edge as an international business, financial and trading centre, action needs to be taken to address perceptions of declining English standards. Meanwhile, in order to take full advantage of the opportunities generated by the Mainland's development, particularly in the GBA, attention also needs to be given to enhancing the general standard of Putonghua. This should be easier to achieve, given that the use and accessibility of Putonghua in HK is increasing all the time. The Government should ensure that the objective of making HK truly a bi-literate/ trilingual society can be attained, by setting out its strategy and policies for achieving this, both within the formal education system and through support for good-quality external language courses. This will help HK to fulfil its role more effectively as a "super-connector", bridging the Mainland and global markets, and support a more diverse community.

To help address some of the issues identified above, we propose a range of measures:

Proposals

- ***Commit to maintaining HK's open markets, the free flow of capital and information, and the integrity of the financial, legal and judicial systems.***
- ***Identify what defines and distinguishes the unique "Brand HK" and be prepared to promote and leverage on our strengths in different ways, which could involve a lighter-touch approach to promotion.***

[18] https://www.ef.com/wwen/epi/

- ***Review HK's investment promotion strategies and policies, and consider the future role of tax and, importantly also, non-tax incentives and benefits to attract investment.***
- ***Maintain and enhance the community's Chinese and English language skills, to help HK to fulfil its role as a "super-connector", bridging the Mainland and global markets, and to support a diverse community.***

Enhance market confidence

Although the Government has made significant efforts to reinforce HK's reputation as an international city and the Financial Services Development Council and InvestHK have launched a global marketing campaign, presenting HK's prospects and opportunities as a bridge connecting the Mainland and the rest of the world, continuous efforts need to be made to showcase HK's advantages and appeal to people around the world. We need to project and present a positive image and highlight HK's strengths, achievements and opportunities, and that the city is a place where people can enjoy a good quality of life and can realize their ambitions and dreams. One of HK's traditional and unique strengths is its diversity and we should treasure and build on this distinguishing facet of HK culture within China. We should promote HK as a vibrant, modern, sustainable and diverse community, and have policies in place to ensure that it can live up to this description. We need to tell the world the good stories, of people from all backgrounds who have succeeded and continue to thrive here.

<u>Expert group/ task force to examine and make recommendations</u>

According to the Census and Statistics Department [19] private consumption expenditure decreased by 1.3% in real terms in the third quarter of 2024 from a year earlier, following a decrease of 1.6% in the second quarter. With a greater variety of shopping, dining, and entertainment options at lower prices, HK residents are spending more of their free time on the other side of the boundary.

According to data released by the Immigration Department, there have been 72.22 million departures from HK since the reopening after the pandemic, with the vast majority travelling to the Mainland, particularly to Shenzhen. In 2023 alone, HK residents made 53 million trips to Shenzhen, which is emerging as an attractive alternative for HK consumers.

A Government spokesperson attributed the city's decline in retail sales to the continued impact of the change in consumption patterns, citing the strong HK dollar and increased outbound travels by HK residents during the summer holiday, among other factors. In October 2024, the executive director of the Hong Kong Retail Management Association was reported as saying that while the interest rate cuts and the recent surge in the stock market were favourable for strengthening the consumption environment, the outlook for whole-year retail sales remained gloomy, and that the Association still maintained its forecast that the overall retail sales for the entire year of 2024 would record a low double-digit decline [20].

We support the Government's efforts in organizing and encouraging a diverse range of events, which have been attracting large crowds. The Hong Kong Tourism Board ("HKTB") has also distributed 500,000 "Summer Triple Rewards"[21] to overnight visitors since mid-July 2024,

[19] https://www.censtatd.gov.hk/en/press_release_detail.html?id=5475#:~:text=Analysed%20by%20major%20GDP%20component,1.6%25%20in%20the%20second%20quarter
[20] https://gbcode.rthk.hk/TuniS/news.rthk.hk/rthk/en/component/k2/1773153-20241003.htm
[21] https://partnernet.hktb.com/en/industry_news/hktb_updates/index.html?id=6907

enhancing the travel experience and boosting consumption in dining, accommodation, transportation, shopping, and entertainment. At the same time, we note that Shenzhen launched the "2024 Golden Bay Consumption Season and Summer Promotion Event," leveraging the opening of the Shenzhen-Zhongshan Link and the summer travel surge, with over 600 promotional activities organized from June to August to stimulate consumer spending[22]. Similarly, the Government should also take steps to stimulate local spending, including promotion campaigns, offers and reward schemes for local citizens.

To bolster market confidence, stimulate local spending and create customized strategies for different industries, we recommend that the Government establish an expert task force on the transition economy to examine the challenges encountered by some of HK's major consumer- and tourism-driven business sectors, such as the retail, food and beverage and tourism sectors, in the increasingly competitive landscape. By focusing on consumer behaviour, economic pressures, and collaboration among stakeholders, the Government can formulate targeted strategies to elevate HK's appeal to both residents and visitors. A deeper understanding of evolving consumer trends in HK and the Mainland, coupled with strategic adjustments to accommodate both domestic and cross-border consumers, could offer a way forward for brands, retailers and developers in the city.

Against the above background, we propose the following measures:

Proposals

- ***Continue to put in place various measures to showcase Hong Kong's appeal to people around the world. Promote Hong Kong's strengths as a diverse community, where people from all backgrounds can thrive and succeed.***
- ***Establish an expert group/ task force on the transition economy to examine and make recommendations on the challenges faced by the local retail, food and beverage, and tourism sectors, etc., given (i) the increasing convenience of cross boundary travel and (ii) Hong Kong's higher cost base than that of Shenzhen and the GBA generally.***
- ***Take active steps to incentivize more local spending, including promotion campaigns, offers and reward schemes for local citizens.***

Review tourism strategies

HK's tourism doors have fully reopened since the beginning of 2023, welcoming back visitors from around the world. The "Hello Hong Kong" campaign launched by HKTB, sent a welcoming message and extended an invitation to visitors to come to HK to experience it in person. This and other campaigns and activities have reached out to the world to promote the city's appeal, and attracted and supported world-class events, as well as conventions and exhibitions ("MICE") events, demonstrating a full resumption to normality, with positive effects. The resurgence of inbound tourism in HK has been promising. By December 2023, tourist arrivals reached 34 million, which is 61% of the annual total in 2019. Cumulatively, about 21 million visitors arrived in HK in the first half of 2024, for a 64% increase year-on-year and a daily average of 116,000 visitors[23]. Despite the positive trend, the competition among the region has intensified as Malaysia, Thailand and Singapore started to offer visa-free travel[24], since 2023, to attract Mainland visitors, among others, and the Mainland itself has been extending visa-free access to tourists from more countries.

[22] https://www.chinadailyhk.com/hk/article/589879
[23] https://www.discoverhongkong.com/content/dam/dhk/intl/corporate/newsroom/press-release/hktb/2024/07-June-Arrivals-E.pdf
[24] https://www.aseanbriefing.com/news/thailand-malaysia-singapore-offer-chinese-visa-free-travel/

Several other factors have also had an impact on the recovery of HK's tourism business, including the appreciation of the HK dollar due to our linked exchange rate system, and the high inflationary environment in many countries in the West post-pandemic, which has limited their residents' spending power.

To strengthen HK's role as a tourism hub, the HKTB has outlined four key strategies in its 2024-25 Work Plan[25], which include developing diversified tourism experiences, staging and supporting large-scale international events, developing diverse visitor source markets and stepping up promotions. Additionally, there is an emphasis on fostering multi-destination tourism with counterparts in the GBA, while continuously supporting the travel trade through various schemes. We suggest that the Government should work with the tourism departments of other GBA cities to offer more choices of combined HK and GBA tours and experiences, highlighting the distinct and unique features of the different places, for inbound tourists.

While the above strategies have helped to sustain a solid recovery in tourism, there is room for more support to ensure a full-fledged recovery and enhance longer-term competitiveness. In addition to stepping up efforts in driving the MICE economy, to attract high-end overnight visitors, the Government should promote the development of sustainable green tourism by enhancing the supporting facilities for key hiking trails and piers, with a view to strengthening the development of HK's green and eco-tourism. In recent years, many overseas locations have focused on developing green tourism in light of its economic and environmental benefits. Australia is one example. Therefore, we believe it is a good timing to review our tourism policies and enhance the promotion of sustainable eco-tourism more actively, in order to instil the concept of "tourism is everywhere in Hong Kong", as mentioned in the 2024 PA (para.129). In this connection, we welcome the Government's proposal to set up a high-level Working Group on Developing Tourist Hotspots.

When reviewing HK's longer-term tourism policies and strategies, careful consideration should be given as to whether we should continue to prioritize numbers of tourists and catering for low-cost tours, which in the past have supported primarily low-paid jobs and even led to some friction with the local population; or whether we should be doing more to promote and cater for higher-end tourism, independent travellers and managed eco-tourism, including attracting more regional and long-haul tourists, who could help reinforce HK's image and reputation as a modern and livable international city that offers much more than just shopping. In the long run, our choices can also help in the drive to attract talent.

In addition to green tourism, arts and cultural tourism are also new travel trends. We appreciate the Government's effort to organize more flagship events, which have attracted local and international media exposure, bringing global publicity value and reinforcing the city's status as an "events capital in Asia". The Government should continue to encourage and support the holding of international arts, culture, and sports events. At the same time, while these events can serve a dual purpose of stimulating local consumption and attracting tourism, we should continue to monitor their effectiveness in terms of these purposes, and assess what has been successful and what less so, and be prepared to make adjustments where necessary.

In addition to various funding schemes, we suggest revisiting the tax treatment of non-resident entertainers and sportsmen in order to attract more high-profile events, including concerts and sports tournaments. Currently, non-resident entertainers or sportsmen and women are

[25] https://www.legco.gov.hk/yr2024/english/panels/edev/papers/edev20240402cb4-373-2-e.pdf

chargeable to tax in the name of the person in HK who pays or credits the sums to that entertainer or sportsman or his/her agent. The HK person who make the payment will become the "Hong Kong payer", i.e., typically the HK promoter or sponsor of the event. Although the withholding tax rate of 10% on income derived from performances in HK[26] is not high compared with neighbouring countries (Thailand 10%[27], Singapore 15%[28], and Japan 20.42%[29]), the reporting obligations for HK payers could add administrative complexity that hinders event organization. We recommend reviewing both the withholding tax rate and administrative procedures, in order to further strengthen HK's appeal for hosting major events.

While HK's outstanding performance in the Olympics in Paris is still fresh in the community's mind, and HK's elite sportsmen and women have continued to shine in World Championship events since the Olympics, the opportunity should be taken to keep the momentum going and develop a stronger sense of community locally, encourage the development of sports culture and promote HK's image. The 2024 PA referred to a series of measures to foster sports development by promoting sports in the community, supporting elite sports, maintaining HK as a centre for major international sports events, enhancing professionalism, and developing sports as an industry (para. 125). In addition to these measures, we suggest that the Government should encourage private sector sponsorship for potential elite sports and athletes by providing enhanced deduction for subsidies and/or donations made to "M" Mark events[30], or sports institutes conducting designated/ elite sports training courses.

We are pleased to note from the 2024 PA (paras. 126 - 127) that, among other expanding tourism infrastructure projects in HK, the Government will complete development of the Kai Tak Sports Park ("KTSP"), and review the redevelopment plan for the Hong Kong Stadium to ensure its synergy with the KTSP, which will be opened in 2025 as a sports and mega events landmark. Featuring a range of sports venues, open spaces, park amenities, retail, and dining options, it is poised to host large-scale events. Therefore, the Government should maximize promotion and/or sponsor the use of KTSP, give its potential to provide high-quality facilities for a variety of major events.

We look forward to the implementation of various measures proposed in the Development Blueprint for HK's Tourism Industry 2.0. In the meantime, we propose consideration of the measures set out below.

<u>Proposals</u>

- ***Review tourism strategies to promote higher-end and eco-tourism. Work with the tourism boards of other GBA cities to offer more choices of combined HK and GBA tours and experiences for overseas tourists, highlighting the distinct and unique features of the different places.***
- ***Continue to encourage and support the holding of international arts, culture, and sports events and exchanges in HK, as well as fostering the development of a vibrant and diverse local arts and cultural scene.***
- ***Revisit the tax treatment of non-resident entertainers and sportsmen.***
- ***Leverage on HK's Olympic and post-Olympic successes to encourage more private sector sponsorship for potential elite sports and athletes, to help develop a stronger***

[26] https://www.ird.gov.hk/eng/pdf/esem_er_none.pdf
[27] https://www.thailand.go.th/issue-focus-detail/006_134
[28] https://www.iras.gov.sg/taxes/withholding-tax/payments-to-non-resident-public-entertainer-(artiste-musician-sportsman-etc-)/withholding-tax-calculations-for-non-resident-public-entertainer
[29] https://www.nta.go.jp/english/taxes/individual/12006.htm
[30] https://www.mevents.org.hk/en/calendar.php

sense of community locally, encourage the development of wider sports culture and promote HK's image.

- ***Consider providing enhanced deductions for private sector donations made to "M" Mark events or sports institutes conducting designated/ elite sports training courses.***

Support the property market

For the past decade, HK's property market has been considered as one of the most unaffordable in the world. According to CBRE[31], property prices have trended downward since the all-time high in September 2021, dropping by 24.2% since the interest rate hike cycle began in mid-2022. In the first half of 2024, the market benefited from the border reopening in 2023, as well as the removal of demand-side management measures for residential properties in February 2024, which stimulated the property market. Yet, following a short rebound, transaction volumes and housing prices have both resumed a downward trend. According to the Hong Kong Monetary Authority[32], the average monthly housing transaction volume rose from 3,300 units in the first quarter of 2024 to 6,000 units in the second quarter. As market sentiment subsequently softened, the average monthly transaction volume fell back to 3,400 units in the third quarter. Official residential property prices declined by 12.5% in the third quarter of 2024 from the same period last year.

In terms of rental market, rents in HK were expected to climb to a record high in 2024[33], surpassing the previous peak in August 2019, because of robust demand from newly-arrived residents, prospective homebuyers currently sidelined by high mortgage rates, and general uncertainty about the market

To further support the property market, for a limited period of, say, five years, the Government may wish to consider allowing purchasers to elect to pay the stamp duty on purchase of self-use residential property in equal annual instalments, over three years from the original stamp duty due date. While this approach will not affect the Government's revenue overall, it could alleviate the immediate financial burden on buyers, making property purchases more accessible and encouraging greater participation in the market. By easing upfront costs, potential buyers may feel more empowered to invest in residential properties, thereby increasing transaction volumes and revitalizing the market.

In addition to the relaxation of the maximum loan-to-value ratios of property mortgage loans proposed in the 2024 PA (para. 170), if further stimulus to the market is desirable, the Government could consider reducing stamp duty (e.g., by 50% where the property value or consideration is up to, say, HK$12 million), for first-time buyers of self-use residential properties, for a limited period of, say, the next three years.

Proposals

- ***To support the property maker and home buyers, for, say, the next five years, subject to review, consider allowing purchasers of residential property for self-use, to elect to pay the stamp duty on purchase by equal annual instalments over a 3-year period from the original stamp duty due date.***

[31] https://www.cbre.com.hk/insights/articles/hong-kong-home-prices-one-of-the-highest-in-the-world
[32] https://www.hkma.gov.hk/eng/news-and-media/press-releases/2024/10/20241016-4/
[33] https://www.scmp.com/business/article/3277365/hong-kong-rents-set-hit-record-high-talent-influx-fuels-demand

- ***If further stimulus to the market is desirable, consider reducing stamp duty (e.g., by 50% for a property value or consideration up to, say, HK$12 million) for first-time buyers of residential property, for self-use, over the next three years.***

(3) <u>Support for research and development, innovation and technology and intellectual property business</u>

One of the roles envisaged for HK under the 14th FYP, is an IP trading hub. However, responding to the concerns of the EU over possible double non-taxation arising from tax exemptions for offshore passive income in HK, the Government made a commitment to refine HK's FSIE regime for passive income. Following two rounds of negotiations and two rounds of legislative changes, as the EU guidance itself changed in late 2022, the further refined FSIE regime came into force on 1 January 2024. Subsequently HK was removed from the EU "grey list" of jurisdictions with, potentially, harmful tax practices.

Following these changes, for foreign-sourced IP income that is received in HK, the nexus approach adopted by the OECD is now used to determine the granting of tax exemptions. While income from certain IP rights (i.e. patents and patent-like IP) may continue to be non-taxable, the legislation has resulted in a very limited scope of non-taxable offshore IP income. This is likely to discourage companies from establishing IP-related businesses in HK.

Against the above background, we welcome the enactment of the Inland Revenue (Amendment) (Tax Concessions for Intellectual Property Income) Ordinance 2024. This legislation introduces a concessionary tax rate of 5% on qualifying IP rights income, including registered patents and copyrighted software. This new "patent box" regime has come into effect and applies from the year of assessment commencing 1 April 2023. It could serve as a valuable complement to the enhanced tax deduction regime for qualifying R&D expenses introduced in 2018. By providing additional incentives for the creation and trading of IP assets in HK, alongside the R&D activities that support them, potentially, the regime will help to boost HK's competitiveness as a regional and international I&T hub, as well as an IP trading centre.

Advocacy of the new patent box regime

While the Institute has held various training events to explain the new patent box regime to members, industry feedback suggests that taxpayers are not well informed about the application of the new regime, and some companies hope to get more details in order to utilize the incentives. To ensure effective participation in the regime and to let businesses understand thoroughly the eligibility criteria and potential benefits available, the Government should work with different sectors to promote and advocate the regime to businesses. Also, the IRD should provide clear guidance and support to taxpayers to maximize tax certainty under the regime.

Holistic review of tax and non-tax incentives for R&D, I&T and IP creation and development

We welcome the initiatives in the 2024 PA that support the development of the innovation economy, such as allocating funds to support I&T and R&D (para. 79), enhancing the legislative framework for IP and strengthen training for IP talents (para. 88). In recent years, innovative technology has become the new impetus of global economic development and HK needs to be prepared to ride this wave to foster long-term economic growth and safeguard its competitive edge.

We believe that, as far as possible, a holistic view should be taken towards encouraging the growth and development of I&T and R&D in HK. As such, in addition to the new patent box regime mentioned above, we hope that the Government will continue to explore enhancements to other IP and R&D-related tax rules that may impact taxpayers' decisions on locating or expanding their IP business here. We are referring to measures such as the existing deduction rules in respect of IP-related and R&D costs; for example, the restrictions on deductions for the acquisition costs of IP assets acquired from associates and payments made for outsourced R&D activities carried out by persons other than "R&D institutions", as defined in the IRO, may need to be revisited. In addition, the coverage of incentives should be extended where some R&D activities are undertaken elsewhere in the GBA. In fact, we believe that it is essential that these rules be enhanced for the patent box regime to work effectively.

In Singapore, the Enterprise Innovation Scheme ("EIS") is available for years of assessment 2024 to 2028, to enhance the existing tax measures and introduce a new measure to encourage businesses to engage in R&D, innovation and capability development activities. In brief, the EIS provides enhanced tax deductions and allowances for various IP-related activities, such as R&D, IP registration, IP acquisition and licensing, training, and innovation, for a broader range of IP assets, including trade secrets or information that has commercial value, which may not be legally protected or subject to approval. Prima facie, HK's regime is not as comprehensive and offers less generous tax benefits for IP-related activities. To maintain HK's competitiveness, the Government should take stock of new developments elsewhere, such as the EIS, and consider introducing additional tax benefits, such as super deductions on other types of IP-related expenditure. It is not so much a question of trying to match other regimes measure for measure, but, rather, taking a step back and assessing whether, taken as whole, HK's IP regime is genuinely competitive.

<u>Simplified group tax loss relief</u>

The group loss relief is available in other IFCs, including the UK, the US, and Australia, together with appropriate anti-avoidance provisions to avoid any abuse. Given that R&D projects often involve substantial upfront costs and uncertain outcomes, the ability to transfer losses could provide much-needed financial flexibility. Hence, we recommend to introduce a simplified group loss relief mechanism to allow R&D companies to transfer their unutilized tax losses to a designated profitable entity within the same corporate group. This straightforward approach would enable R&D groups to better manage their financial resources, as they could utilize losses incurred during the high-investment phases of R&D against profits generated by other group members.

Apart from the above tax incentives and initiatives, the Government should also explore other possible non-tax support measures, to help create an environment conducive for businesses to invest in R&D and IP. These measures may include, among other initiatives, the provision of financial subsidies to encourage more local R&D activities, the streamlining of IP registration procedures and simplification of requirements for application documents, etc. We propose consideration of the measures set out below.

<u>Proposals</u>

- ***Government should work with different sectors to promote and advocate the new patent box regime to businesses.***
- ***Conduct a holistic review of tax incentives for R&D, I&T and IP creation and development and also explore other non-tax incentives, including those offered overseas. For example:***
  - ***introduce a simplified form of group loss relief for R&D companies – by election and designating a particular company's losses to offset against profit***
  - ***consider R&D tax credits for start-up businesses, particularly in strategic sectors, such as I&T and green industries, and BEPS-compliant "Qualified Refundable Tax Credits", where appropriate***

- ❖ ***modify the enhanced R&D and IP tax deduction rules and extend their coverage to accommodate, where reasonable, the real commercial practices of businesses engaged in these activities; for example, deductions for costs of acquiring IP from associates, IP licensed to other persons for use outside Hong Kong, and for the costs of outsourced, arm's length, R&D activities***
- ❖ ***consider non-tax support, including possible financial subsidies, to encourage more local R&D activities.***

(4) Streamline and update aspects of Hong Kong's business laws and regulations

Business licensing and bank account opening procedures

As an important part of the process of setting up a business in HK, licensing systems should be reviewed periodically to identify any unnecessary procedural hurdles and to see where further streamlining, including digitalization may be possible.

Businesses often complain about the difficulties in opening bank accounts in HK. As a member of the Financial Action Task Force and an IFC, HK needs to maintain, and to be seen to be maintaining, effective anti-money laundering and counter-terrorist financing controls. At the same time, a balance must be struck to ensure that while criminal businesses are discouraged from operating in HK, legitimate business are welcomed. It is not always clear that we have found the right balance. Ideally, all relevant parties on the business facilitation and regulatory side should be pulling in the same direction.

Introduce a statutory corporate rescue procedure and insolvency trading provisions

HK is almost certainly the only major financial and commercial centre that does not have a formal procedure for corporate rescue. The Law Reform Commission first proposed a statutory corporate rescue procedure ("CRP") in 1996 and, despite two unsuccessful attempts to proceed with legislation in the early 2000s, and another draft bill being prepared in 2021, the legislation appears to have stalled again and there is no clear timetable for a bill to be introduced into LegCo.

Enhancing laws relating to restructuring and insolvency ("R&I") should not be seen as a negative reflection on the state of the economy at any given time, but a long-term investment in a modern and comprehensive framework of business law and regulation that can help attract investment, including from financial institutions and related entities that may be lenders to businesses. Other jurisdictions in the region are aware of this and some of them have been developing their own R&I laws to offer a range of options for companies in financial distress and tools for private sector insolvency practitioners ("PIPs"), with the aim of improving the overall environment for business in their jurisdictions, and advancing their own status as R&I centres. The main aim of the CRP is to help sound businesses that may be facing short-term cash flow problems to get back on their feet, and not having any statutory procedure in this sphere disadvantages HK. In the World Bank's inaugural "Doing Ready" Report, referred to above, Business Insolvency was one area where HK fared poorly and ranked in the fourth quintile. Clearly, we need to do better.

Another aspect of the proposed CRP bill, which PIPs regard as vital, is the inclusion of "insolvent trading" provisions, to encourage company directors to make use of the rescue procedure at the earliest stage rather than to continue trading, usually in the vain hope that this will enable them get out of insolvency. In practice, the company will often go deeper into debt and creditors will suffer. Given the unique situation in HK where many companies with a listing and/or operations in HK are incorporated outside of HK and their directors are often based outside of HK, PIPs frequently find that nearly all the assets of companies in liquidation have been depleted or removed, and the directors are not in HK and are unreachable. Overseas, insolvent trading provisions have helped to encourage better conduct from directors of companies in financial distress. The fairly recent case involving the overnight closure of multiple branches of the Physical Fitness gym, with reportedly, millions of dollars owed to customers, and with customers being sold new gym packages only weeks, or even days, before the closure was announced, is a clear demonstration of the need for action in this area.

While we understand that some parties may have doubts about the benefit of the CRP bill, and consider existing informal arrangements, or schemes of arrangement, are sufficient, we believe that this is based on misconceptions about CRP, which need to be addressed.

If, however, the CRP has ceased to be a priority for the Government, we suggest that alternatives be looked at. One option would be for the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) ("CWUMPO") to be amended to allow for provisional liquidation to be used for restructuring, with the introduction of a moratorium period on actions by creditors (as also provided for under the CRP). A CRP framework and more flexible provisional liquidation arrangements are available in various jurisdictions around the world and in this region. Due to the absence of similar procedures in HK, it started to become quite common for "light touch" provisional liquidations of companies with substantial interests in HK to be initiated in offshore jurisdictions, where the companies may be incorporated or have other connections, and for the officeholders to then seek recognition and assistance in the HK court, under common law recognition arrangements. Given the prevalence of these actions, the HK court has felt compelled to lay down criteria for giving recognition, in order to prevent abuses of procedure. This is clearly an unsatisfactory state of affairs, which has come about, as indicated above, because HK does not have its own CRP or more flexible arrangements for provisional liquidation.

<u>Provide for creditors' and other R&I-related meetings to be held virtually</u>

The Companies (Amendment) Ordinance 2023 was passed and came into operation on 28 April 2023. This modernized the Companies Ordinance ("CO") and the Model Articles to cater expressly for companies to hold fully virtual general meetings ("GMs"), without the requirement for presence of members at any physical locations; as well as allowing for a mixed mode of virtual GMs, with some members attending at a physical location(s), i.e., hybrid GMs.

In contrast to the above, there is no guidance in the Bankruptcy Ordinance (Cap.6) ("BO") or CWUMPO on whether creditors' meetings can be convened virtually. In fact, the Official Receiver issued a letter on 8 February 2023 to remind PIPs that, as all social distancing measures had been lifted, the normal meeting arrangements (i.e., physical meetings) should be resumed for meetings of creditors and contributories in bankruptcy and/ or winding-up proceedings, in accordance with the relevant provisions under the BO/ CWUMPO.

Virtual meetings would enhance accessibility for all stakeholders, particularly in a globalized environment where creditors may not be based in HK. Allowing remote participation, would help to ensure that all voices could be heard during critical discussions, fostering inclusivity and transparency in the insolvency process. In addition, virtual meetings can streamline proceedings, reduce costs associated with travel, and facilitate quicker resolutions - essential factors when time is of the essence in corporate rescue scenarios. Promoting this modern approach not only aligns with global best practices but also reinforces HK's commitment to maintaining a robust and efficient insolvency framework that can adapt to changing circumstances.

During the pandemic, many meetings of creditors and contributories took place remotely, or in a hybrid mode, and no complaints were received. The court set out some basic parameters for conducting virtual/ hybrid meeting during that period. This being the case, the reversion to holding physical meetings only seems to be a backwards step. Therefore, CWUMPO and the BO should be amended to make it clear that holding creditors' meetings in a virtual or hybrid format is permissible.

Proposals

- ***Keep business licensing arrangements under review and streamline and digitalize them, where possible, and examine the difficulties that some companies face when trying to open corporate bank accounts.***
- ***Introduce a corporate rescue regime or explore alternatives, such as enabling provisional liquidation under CWUMPO to be used for restructuring and to include a moratorium on creditor actions.***
- ***Provide for virtual creditors' and other insolvency meetings under CWUMPO and the BO.***

Theme II: Attracting, developing and retaining talent in Hong Kong

Overview

HK continues to face strong competition in the global push for talent. It is also facing a workforce shrinkage due to the ageing population and declining birth rate, and some people departing from HK. Meanwhile, the skills of many capable seniors are underutilized due to traditional retirement practices, while women often leave employment for child-rearing and caregiving responsibilities. To encourage seniors and stay-at-home parents to re-enter the workforce, the Government should foster an inclusive work environment and promote the acceptance of older employees. Additional measures to support childbearing amid the continuing low birth rate are also important and these should include encouraging businesses to adopt more flexible, family-friendly policies and practices.

In addition to retaining and developing the skills of the workforce, the Government should prioritize nurturing talent in the R&D, I&T and IP sectors to drive sustainable economic growth. As the global economy increasingly relies on technological advancements, a suitably skilled workforce is essential and will help position HK as a leading hub for innovation in Asia, and contribute to a more resilient economy.

Proposals

(1) Talent shortage

Attract and retain talent

According to the Office of the Government Economist[34], HK's labour force was on a general uptrend in the past 30 years and peaked at 3.68 million in 2018. Then it started to decline and reached a low of 3.46 million in 2022, before recovering to around 3.50 million in 2023, with the assistance of various admission schemes, such as the Top Talent Pass Scheme ("TTPS"). Yet, it was still 4.9% lower than the peak in 2018 as some productive people have continued to take advantage of residence and immigration schemes overseas. Looking ahead, the population ageing will continue to put downward pressure on the labour supply in the long term.

Over 70% employers are still struggling to find the right candidates despite the larger pool of tech talent, according to a survey by Robert Walters Hong Kong[35]. The survey, which polled over 120 business leaders in the tech sector, said 50% of employers are facing a talent shortage at the managerial level, especially in the digital transformation sector. Due to the urgent need for talent, professionals can often command 15% to 20% salary increases when moving to new permanent roles. With more working visas being issued under the TTPS, employers can tap into the GBA to fill their skills gap. Many companies are also offshoring roles to Southeast Asia, the survey also found. We believe that the provision of some additional support, for a limited period, for targeted industries facing labour shortages should be considered.

We recognize the Government's efforts in implementing various measures to help boost the labour supply in recent years, including the TTPS and the special scheme to import care workers for residential care homes in June 2023. We also appreciate that the Government reviewed and expanded the talent list from 13 to 51 professions across nine industry segments, under the Quality Migrant Admission Scheme, the General Employment Policy and the Admission Scheme for Mainland Talents and Professionals in May 2023. We welcome the impressive number of applications and approvals under the various talent admission schemes. We believe that

[34] https://www.hkeconomy.gov.hk/en/pdf/el/el-2024-01.pdf
[35] https://hongkongbusiness.hk/hr-education/news/why-talent-crisis-persist-despite-larger-pool

implementing the proposal to update the talent list to attract candidates from more professional service sectors and extending the eligible list of universities to 199, under the TTPS, should help the accounting profession to attract non-local talent and further expand the talent pool of the profession in order to maintain the service quality of the accounting profession in HK. As mentioned in the 2024 PA (para. 61), the Government signed the Second Agreement Concerning Amendment to CEPA Agreement on Trade in Services in October 2024, which lowers the threshold for HK professional services industries, including the accounting profession, to enter the Mainland market. This should also facilitate HK practitioners to explore development opportunities in the Mainland.

Notwithstanding the above, we believe that additional measures could be taken to attract and retain talent in HK. For example, visa application procedures could be simplified and a green channel opened for GBA and foreign students to come to HK for internships, and more support could be offered to employers in targeted industries facing talent shortages (such as I&T and "green" industries).

Proposals

- ***Provide time-limited subsidies or tax concessions, e.g., double deductions, to targeted industries facing talent shortages, so that employers can offer more competitive salaries.***
- ***Enhance talent mobility: Connecting HK to the GBA and global markets, including simplifying the visa application procedures and opening a green channel for GBA and foreign students to come to HK for internships in the accounting and other sectors, during the peak seasons.***

Encourage child birth and attract overseas talent to raise their families in Hong Kong

According to the 2024 mid-year population statistics released by the Census and Statistics Department[36], HK's population was 7,531,800 at mid-2024, representing an increase of 0.1% from end-2023 and a decrease of 0.1% from mid-2023. A government spokesperson pointed out that, benefiting from various measures on talent attraction and labour importation, there was sizable inflow of persons from the Mainland and other places around the world to HK in the first half of 2024, resulting in an increase in the population as at mid-2024 as compared to end-2023[37]. On the other hand, following the full resumption of normal travel in early 2023, quite a number of HK residents who were living abroad returned to HK for a short duration. As a result, the population recorded a notable increase as at mid-2023 as compared to a year earlier.

The number of births in HK declined from 55,000 in 2017-18[38] to 34,400 in 2023-24[39]. With HK experiencing a record low fertility rate of 0.99 births per woman, legislators and academics have offered different recommendations to tackle the challenges. The downward trend has been affecting enrolments in schools and will eventually have an impact on the workforce, as well as exacerbating the ageing population situation. The newborn baby bonus, which provides a one-off cash bonus of HK$20,000 for each baby born in HK on or after 25 October 2023, announced in the 2023 PA, may have served as a short-term measure to encourage childbirth, leading to a slight increase of number of births from 32,600 in 2022-23 to 34,400 in 2023-24. This measure will last until October 2026 and will then be reviewed. In addition to this, we suggest that consideration be given to increasing the general child allowances.

[36] https://www.censtatd.gov.hk/en/press_release_detail.html?id=5448
[37] https://www.info.gov.hk/gia/general/202408/15/P2024081500261.htm
[38] https://gia.info.gov.hk/general/201808/14/P2018081400417_290006_1_1534230860677.pdf
[39] https://gia.info.gov.hk/general/202408/15/P2024081500261_467940_1_1723704757994.pdf

Continuing support for working parents was announced in the 2024 PA, with the setting up of one more child care centre and increasing service places under the Neighbourhood Support Child Care Project by 25% (para. 204). Besides the above, the Government should take a holistic approach and develop more long-term policies to help create a more family-friendly society. Triggered by the pandemic, many companies provided more flexible work models and utilized technology to adapt to the "new normal" in the workplace. In the post-Covid-19 environment around the world, some businesses have continued to adopt a hybrid WFH/ in office model, as a way to help employees maintain a better work-life balance and improve their physical and mental wellbeing, and also, potentially, to reduce their own costs, as they can reduce the amount of physical office space required. The facility to adopt a hybrid/ WFH model can be attractive to working parents, particularly when their children are at the pre-school age. Other child-friendly policies should also be encouraged, such as flexible working arrangements, part-time work and creating suitable spaces for breastfeeding on site, etc.

Furthermore, to encourage overseas talent to come to HK and raise their families here and stay for the longer term, support should be provided for their children's education, where the local school system cannot accommodate their needs.

Proposals

- ***Consider doubling the personal allowances under salaries tax of parents with newborn babies, for the first two years after the child's birth.***
- ***Encourage businesses to allow WFH/ hybrid working for employees in the first one or two years after the birth of their children.***
- ***Encourage employers to implement other family-friendly policies, such as flexible working arrangements, part-time work and also creating suitable spaces for breastfeeding on site.***
- ***Provide an allowance for the private education of the children of overseas talent, up to a certain limit annually.***

Retain and develop the skills of the workforce

To support members of the workforce who want to upgrade their skills and thus improve their opportunities and competitiveness, we suggest allowing more flexible use of the deduction for self-education expenses, currently capped at HK$100,000. We suggest expanding the scope of the deduction to cover expenditure incurred by a taxpayer's dependants, if they are not eligible for the deduction in their own right.

Furthermore, we recommend that the Government consider subsidizing employers to send employees on qualifying courses to upgrade their skills in areas that are most in demand, such as the I&T field. In addition, any such training should not be treated as a taxable perquisite in the hands of employees.

<u>Encourage stay-at-home parents and skilled retirees to join/ return to the workforce</u>

With an ageing population and a declining birth rate, HK's workforce is expected to shrink. At present, there are about 1.8 million older persons aged 65 or above and the number is projected to increase to 2.2 million by 2032. People are generally living longer nowadays than the time when 60 or 65 was seen as a natural retirement age. Many people are still quite capable of working beyond this age and are willing to stay in employment. They should be given opportunities and encouraged to do so. On the other hand, despite women comprising the majority of university graduates, only around 53% of women are in the workforce in HK[40].

[40] https://www.censtatd.gov.hk/en/web_table.html?id=210-06201

According to a Women's Foundation survey conducted in 2019[41], around 30% of women drop out of the workforce due to caring responsibilities, such as childcare and elderly care. To replenish its talent pool, the Government should take the lead in encouraging businesses to recognize the value of having older workers and women with children in the workforce and to create a supportive and inclusive work environment that maximizes the potential of the community.

In recent years, the Government has been strengthening support for working families in their childbearing stage, including increasing child care centre places and allowances, extending the after-school care programmes for pre-primary children to cover all districts, and strengthening the home-based child care service. We acknowledge these efforts, while proposing further initiatives to support and incentivize stay-at-home parents to transition back to the workforce.

We are pleased to note the launch of the three-year Re-employment Allowance Pilot Scheme[42] in July 2024, with more than 20,000 participants, as mentioned in the 2024 PA (para. 211). The Government should continue to encourage experienced and skilled seniors and retirees to stay in or return to the workforce by raising the standard retirement age in the civil service to 65 years old, with an option to stay on until, say, 68. Those within that bracket who have already retired and who are interested to return to full- or part-timework should be considered for re-engagement. The Government should also encourage insurance companies to extend the coverage of the employee medical care insurance plans accordingly.

With this in mind, we propose that the following measures be considered:

Proposals

- ***To encourage local talent back to the workforce, consider offering double basic salaries tax allowances for parents with newborns (see above), and individuals aged 65 and above, for two years.***
- ***Encourage employers to introduce more flexible work policies, e.g., WFH/ hybrid working, part-time work, seasonal employment and flexible retirement arrangements.***
- ***Expand the deduction for self-education expenditure to cover expenditure incurred by taxpayers' dependants.***
- ***Subsidize employers to send employees on qualifying courses to upgrade their skills.***
- ***Offer targeted training programmes and career counselling services to support stay-at-home parents and seniors in updating their skills, and give them opportunities to return to the workforce.***
- ***Government should take the lead in giving staff the option to defer their retirement age to 65 - 68 (for both civilian and, where practical, disciplined services officers); and also offer incentives to employers to hire and retain experienced older people in employment.***

Nurture talent in key areas for Hong Kong's future development, including R&D, I&T, sustainability and green finance

[41] https://twfhk.org/sites/default/files/twg_gender_infographic_pdf.pdf
[42] https://www.info.gov.hk/gia/general/202407/15/P2024071200291.htm

We welcome measures proposed in the 2024 PA, including the introduction of regulatory arrangements for local patent agent services (para. 91), developing IP teaching materials for deployment by training providers (para. 92), and promoting STEAM (science, technology, engineering, the arts and mathematics) education in primary and secondary schools (para. 113), etc. STEAM and I&T education will play a pivotal role in nurturing a new generation of young people to become a force in I&T in the future.

At the same time, the Government should invite support for STEAM education through initiatives like "sandwich" courses, industry placements, and scholarships to cultivate a skilled workforce that can drive innovation and industry growth. By offering more specific support to universities and research institutions for specialized courses and hands-on training in areas such as R&D, I&T, sustainability, and green finance, HK students can be better equipped with the necessary competencies to meet the demands of a rapidly evolving economy.

Industry feedback indicates a need for subsidies to cover part of the costs incurred by companies to invite international experts for professional training of their local R&D staff in HK. By facilitating access to global expertise, such subsidies would enable companies to upskill their workforce, particularly in rapidly developing fields like technology and sustainability, where staying competitive requires continuous learning and adaptation. By investing in the training of R&D staff with the assistance of international expertise, HK can strengthen its position as a leading I&T hub. Given the global shortage of expertise in sustainable finance, consideration should also be given to extending or regularizing the Pilot Green and Sustainable Finance Capacity Building Support Scheme[43] to promote training to build a robust talent pool in green and sustainable finance.

<u>Proposals</u>

- ***Invite support for STEAM education, e.g., through "sandwich" courses, industry placements, scholarships, etc. and offer more specific support to universities and research institutions to provide specialized courses and hands-on training in R&D, I&T, sustainability and green finance.***
- ***Provide subsidies to cover part of the costs incurred by companies to invite international experts to provide professional training to their Hong Kong R&D staff.***
- ***Extend or regularize the Pilot Green and Sustainable Finance Capacity Building Support Scheme, to promote training to build up the local green and sustainable finance talent pool.***

Provide leadership training

Leadership training is crucial in HK, particularly as the city navigates complex social, economic, and environmental challenges. As industries evolve with technological advancements and global competition, well-trained and prepared leaders are essential to foster innovation and adaptability within organizations. Leadership training enhances awareness of pressing community issues, enabling leaders to make informed decisions that positively impact society. In addition, as climate change and sustainability become increasingly critical issues, future leaders must grasp the importance of these issues and be equipped to implement sustainable practices within organizations. By investing in leadership training, HK can cultivate a new

[43] https://www.greentalent.org.hk/

generation of leaders who are not only skilled but also socially conscious and capable of driving meaningful change in the community.

Proposals

- ***Provide support for schools and universities to establish leadership training courses to develop the next generation of leaders who should have -***
  - ***Strategic knowledge and vision***
  - ***Awareness and understanding of the issues facing the community and society***
  - ***Understanding of the importance of technology and other forces of change, including climate change, etc.***

(2) Alleviate living cost of citizens

Community support

Since 2019, Hong Kong has consistently held the title of the world's most expensive city for expats, according to Mercer's Cost of Living survey[44]. The combination of limited housing supply and increasing demand has further exacerbated the situation, making it increasingly challenging for residents to afford basic living expenses. Rents in HK also increased by 8% in 2024. This ongoing trend underscores the significant financial burden placed on individuals and families. Furthermore, increases in transportation costs, including MTR fares[45], by 3.09% in 2024-25, following a 2.3% rise in 2023-24, in taxi fares[46], ranging from 8.86% to 10.92% (effective from July 2024) and bus fares, ranging from 4.3% to 7.5%, have further increased the financial burden faced by families.

On the business front, HK's food and beverage industry is expected to face a challenging environment due to elevated costs of living, ongoing supply issues and labour shortages, coupled with the recent trend of more HK people spending their weekends in Shenzhen, due to the lower prices and improvements in the quality of service in the Mainland. Various sectors of the community will continue to need some additional help in the present economic climate. Furthermore, in view of the rising cost of living, working people will inevitably need to save more for their retirement.

Therefore, to help alleviate the ongoing burden on taxpayers and other members of the community, we propose the measures below.

Proposals

- ***Provide a tax reduction of 100%, subject to a ceiling of HK$6,000, on salaries tax, tax under personal assessment and profits tax for 2024-25.***
- ***Provide a rates concession for properties owned by natural persons for three quarters, subject to a ceiling of HK$1,200 per quarter. Consider restricting the rates concession to properties with ratable value of HK$200,000 or below only, or to standard-band properties under the new progressive rates system.***
- ***Grant an electricity charge subsidy of HK$1,000 to each residential and commercial electricity account, in conjunction with promoting energy conservation measures.***

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[44] https://www.mercer.com/insights/total-rewards/talent-mobility-insights/cost-of-living/?utm_source=google&utm_medium=cpc&utm_campaign=Cost_Of_Living_Search&gad_source=1&gclid=EAIaIQobChMI2drXqoGfiQMVFNMWBR2OdwehEAAYASAAEgL4UPD_BwE#full-ranking
[45] https://news.rthk.hk/rthk/en/component/k2/1759650-20240630.htm
[46] https://www.news.gov.hk/eng/2024/05/20240514/20240514_171830_179.html?type=ticker

- ***Consider expanding "qualifying tenancies" eligible for the rental deduction for salaries tax purposes, to cover rental of a serviced apartment by means of a licence.***
- ***Increase the maximum tax deduction for qualifying premiums paid under the Voluntary Health Insurance Scheme ("VHIS") to HK$12,000 per each insured person, and consider extending the scope of VHIS to other programmes, e.g., outpatient services.***
- ***Increase the maximum tax deduction for qualifying annuity premiums and voluntary mandatory provident fund contributions to HK$80,000.***
- ***To promote a more active and healthy lifestyle, provide a tax deduction for expenses on approved sports courses and activities for taxpayers and dependants, of up to HK$12,000 per person.***

Review and rationalize personal allowances

The amount of the personal allowances under salaries tax and personal assessment has not been revised since 2018-19. The basic personal allowances should be increased in line with inflation.

The Government should also review and rationalize the allowances for dependants. Allowances for children and other dependants have been revised at various times over the past decade or so, often with differing levels of increases applied to the different allowances. Pending a review, generally, the allowances for dependants should also be increased at least in line with inflation. Following any review, future adjustments should be made on a more transparent and consistent basis. Where there are sound policy, or other reasons for differential adjustments, these should also be made clear. As suggested above, this could, for example, involve larger increases for child allowances to encourage more couples to have children.

Proposals

- ***Increase basic personal allowances at least in line with inflation.***
- ***Review the allowances for dependants and ensure any future adjustments are made on a more transparent and consistent basis.***

Theme III: Sustaining public finances

Overview

In 2023-24, HK suffered a budget deficit of over HK$100 billion hard on the heels of a HK$122.3 billion deficit the previous year, highlighting the need to enhance government revenue and control and optimize public expenditure. The deficits led to a drop in the fiscal reserves to HK$734.5 billion, as at 31 March 2024, the lowest level since 2012-13. As at the end of November 2024, the fiscal reserves stood at the equivalent of around 9.1 months of government expenditure. At the same time, this needs to put into some perspective. The deficit to GDP ratio for HK in 2023 was around 3.3%. This compares with over 6% in the US and 4.4% in the UK. It is reported that, in 2025, the Mainland is planning to budget for a deficit to GDP figure of 4%. Against these benchmarks, HK's current financial position should not be seen as anything extraordinary. While HK has also enjoyed extended periods of substantial surpluses in the past, this could arguably be seen as the more unusual scenario compared with other developed markets. As regards the fiscal reserves, HK's financial strength should not be measured by these alone, as the Exchange Fund managed by the Hong Kong Monetary Authority, which also includes the fiscal reserves, has total assets of over HK$4 trillion. While a significant portion of the Exchange Fund assets are there to support the HK currency, nevertheless, this is indicative of HK's overall financial strength. It is also true that the situation is dynamic, so we cannot afford to be complacent and must monitor events carefully and actively to ensure that it does not deteriorate significantly.

We support the Government's efforts to identify new revenue and funding sources while seeking to control the growth of total government expenditure, and asking for 1% cuts annually this year and next. Targeted tax measures have been introduced over the past year, including a two-tier standard rate tax regime, for salaries tax and tax under personal assessment, which targets high-income earners, and a progressive rating system for domestic properties, with higher rates applicable to properties with a higher ratable value. In addition, the FS has previous indicated that the implementation of the BEPS 2.0 Pillar 2 "GloBE rules" and related measures in HK should result in some additional revenue in the years ahead, when HK-based constituent entities of in-scope of MNEs start to file their GloBE returns, in 2027.

On the expenditure side, the amount earmarked for one-off relief measures plunged 80.6% to HK$11.5 billion in 2024-25, compared with HK$59.4 billion in the previous year. Meanwhile, of the total government expenditure in 2024-25, recurrent expenditure is set to grow by 7% to HK$580.2 billion in 2024-25, while the increase in the following four financial years is expected to slow to between 3% and 4.3% per year.

Proposals

To ensure sustainable public finances, we continue to call for a more extensive review of HK's tax system. A review should, for example, consider issues of tax certainty and the competitiveness of the tax regime, it should explore options for new broader-based taxes to help stabilize revenues, and look at the effectiveness of existing policies and incentives. In terms of new sources of revenue, we note elsewhere in this submission that the implementation of the BEPS GloBE rules in HK, together with the introduction of a HK domestic minimum "top-up tax", is expected to bring in some additional revenue. We also agree that increasing government revenue through measures such as a two-tier standard rate salaries tax regime, can provide additional income without significantly impacting the livelihood of citizens. In fact, we think that there is scope for a further moderate increase in the higher-tier standard rate.

At the same time, optimizing public expenditure is critical to controlling costs and ensuring that resources are allocated efficiently to essential services like housing, healthcare, education, welfare and digitalization.

By focusing on both enhancing revenue streams and managing expenditures effectively, HK can work towards restoring fiscal balance while continuing to support economic growth and public welfare initiatives. This approach is vital for maintaining the city's long-term financial health and competitiveness in an increasingly complex world.

(1) <u>Enhance government revenue</u>

Conduct a more extensive review of Hong Kong's tax system

While we have been advocating this for several years already, we continue to urge that a more extensive review of the tax system be conducted. International tax developments, such as those referred to above, the importance of safeguarding HK's competitive position, retaining a simple, relatively low-rate tax regime, as far as possible, while also being able to fund vital public services, against the backdrop of HK's ageing population and increasing dependency ratio, point to the need for a tax system that is responsive, up to date and fit for purpose. It has been over 45 years since the previous review of the IRO and, although numerous changes have been made since that time for specific purposes, the framework has not been re-examined from a holistic perspective. It is time to look more thoroughly at our tax legislation and system.

In view of the above, there is an increasing need to explore alternative, preferably broader-based taxes to ensure stability of revenues in the future, to help address the longer-term public finance needs and avoid structural deficits. This is important given the lack of indirect, consumption-based taxes and over-reliance on a few sources of revenue, primarily profits tax, salaries tax, land premiums, stamp duty (a large proportion of which is also property-related), and investment income - all of which are quite volatile. In this regard, we note that due to pressure to try to improve market liquidity, the Government reduced the stamp duty chargeable on the sale or purchase of any HK stock, from 0.13% to 0.1% of the consideration or value of each transaction payable by buyers and sellers respectively. This took effect in November 2023. In the real estate market, all demand-side stamp duty measures to cool the previously-over-heated residential property market, which had lasted for over 13 years, were abolished in February 2024. However, it is not clear that these measures have had the desired effects so far, given the importance of a range of other factors contributing to investors' decisions to enter the market, including the interest rate environment.

Evidence suggests that other factors are generally more important than stamp duty when it comes to the liquidity of the stock market. At least for the time being, that also appears to be the case for property transactions. However, while property sales are relatively quiet, the rental market is very buoyant and likely to remain so, for a variety of reasons. We believe that, in this environment, consideration should be given to increasing the stamp duty on leases of residential properties.

As regards new sources of revenue, the GlobE rules will impose a global minimum effective tax rate on large MNE groups. Although, on the one hand, this may impact HK's ability to attract business from in-scope groups on the basis of offering low tax rates, on the other hand, it is expected to result in some additional revenue. Like a number of other jurisdictions, HK will introduce a domestic minimum top-up tax regime, to ensure that it does not give up its taxing rights to other places (generally the jurisdiction of the ultimate parent entity of the MNE group) where the effective tax rate of the HK-based constituent entities of the group is less than 15%. In the 2022-23 budget speech, the FS estimated the additional revenue from this source to be, roughly, HK$15 billion[47]. As the Government should now have more information on hand about the affected MNE groups, it should provide an updated estimate on the additional revenue likely to be derived from the implementation of the proposed HK Minimum Top-up Tax ("HKMTT") to give a clearer picture of HK's expected financial position. By more accurately assessing the potential revenue from the HKMTT, the Government can plan its fiscal policies and allocate resources more effectively.

Overall competitiveness of Hong Kong's tax system

In the light to the tax changes explained above, a review of the existing policies, preferential regimes and other tax incentives is called for to assess their effectiveness in achieving their stated objectives.

The Government should research into how the tax system could be used better to support policy objectives, such as developing HK's role as an IP hub, and providing more assistance to start-up businesses that cannot make use of the existing incentives. We welcome the Government's recent proposal to add to the scope of qualifying transactions eligible for tax concessions for funds and single-family offices, in order to attract more global capital to be managed in HK (PA, para. 38). We also support the exploration of potential new growth areas, such as establishing an international gold and commodities trading market, by introducing tax concessions, and support measures to attract relevant enterprises in the Mainland and overseas to set up businesses here (PA, para. 52).

Given the increasing focus on, and importance of, sustainable development, the Government could also consider green taxes and incentives (e.g., emission taxes, additional carbon taxes, incentives for energy conservation, etc.). Push and pull measures can be used to increase the take up of electric vehicles ("EVs") and encourage the development of new energy vehicles, including commercial vehicles and public transport, in order to help achieve a carbon neutral HK by 2050 (see Theme IV below). New business models also need to be understood and accommodated.

Proposals

- ***Conduct a more extensive review of Hong Kong's tax legislation.***
  - ❖ ***Review the tax system for its competitiveness and ability to provide sufficient revenue for Hong Kong's future development needs.***
  - ❖ ***Review the effectiveness and competitiveness of the existing preferential tax regimes.***
- ***Provide an updated estimate on increase revenue derived from the implementation of the Hong Kong Minimum Top-up Tax.***
- ***Consider increasing the stamp duty on leases of residential properties.***
- ***Consider increasing the higher-tier standard rate from 16% to 16.5%.***

Infrastructure toll

Recent statistics indicate that HK residents made over one million outbound trips during holidays in 2024, with a substantial portion heading to the Mainland[48]. This trend reflects a

[47] https://www.budget.gov.hk/2022/eng/pdf/e_budget_speech_2022-23.pdf (para. 188)
[48] https://news.rthk.hk/rthk/en/component/k2/1759650-20240630.htm

growing pattern of cross-border and overseas travel that significantly impacts local businesses and increases the demand for maintenance of facilities and infrastructure at various control points. The high volume of travellers not only strains existing resources but also necessitates enhanced services to accommodate the influx of residents seeking leisure and shopping opportunities across the boundary. To address these challenges through improved infrastructure and services, the Government should consider imposing an infrastructure toll on all private and public ground transportation entering specified HK control point locations. A similar type of impost has been levied for a number of years on departures by air through the airport departure tax, used to help pay for airport infrastructure development. Overall, a relatively modest infrastructure toll would not only help manage the increasing demand for cross-border travel but also contribute to sustainable urban development in HK.

Starting from December 2023, the Government has implemented Time-varying Tolls ("TVTs") at the three road harbour crossings, namely the Western Harbour Crossing, the Cross Harbour Tunnel, and the Eastern Harbour Crossing. The TVTs apply to private cars and motorcycles. Different toll levels are charged at different time slots in order to suppress and divert the excessive traffic demand during peak hours, thereby alleviating the cross-harbour congestion. The toll plan also simplifies the toll structure and reduces the Western Harbour Crossing tolls for commercial vehicles, which facilitates the operation of trade. The Government should periodically review and adjust toll rates, taking into consideration both public finances and the current state of the economy.

Proposals

- ***Consider imposing an infrastructure toll on all private and public ground transportation entering specified Hong Kong control point locations.***
- ***Review and adjust toll rates of road tunnels periodically, having regard to both public finances and the current state of the economy.***

(2) Optimize public expenditure and funding of capital works

The Government's expenditure has grown almost three times faster than revenue in the past decade, affecting the city's fiscal reserves. The current situation has sparked calls from economists and politicians to review the administration's approach to spending[49]. Faced with the pressure on public finances, the Government has decided that bureaus and departments should jointly implement a Productivity Enhancement Programme, under which bureaus and departments are required to cut 1% recurrent expenditure allocation in 2024-25 and a further 1% in 2025-26. As noted above, recurrent expenditure is expected to amount to over 90% of revenues in 2024-25, so this is a key area where prudent financial management must be exercised. Resources spared will be re-allocated for the implementation of new policy initiatives. The objectives of the programme are to control the overall growth of government expenditure and encourage bureaus and departments to achieve savings, through business process re-engineering and re-prioritization. This will provide greater room for internal reallocation of resources, improving existing services and implementing new services to achieve higher efficiency.

We support the Government's efforts to control public expenditure and save costs in the current fiscally-constrained environment. Traditionally the Government has sought to follow the principle of keeping expenditure within the limits of revenues in drawing up the budget, striving to achieve a fiscal balance, avoid deficits and keep the budget commensurate with the growth rate of GDP.

[49] https://www.scmp.com/news/hong-kong/hong-kong-economy/article/3253098/hong-kongs-public-spending-has-grown-3-times-faster-its-revenue-now-experts-are-calling-authorities

This is a fiscally prudent approach, which should continue to be the overall guiding principle, even if, from year to year, certain adjustments and accommodations may need to be made, depending on the state of the economy. The Government should continuously assess its spending to identify opportunities for cost reductions, streamline operations, eliminate inefficiencies, and where possible, enhance automation. Embracing automation where feasible, can not only save costs in the long run, but also improve service delivery, operational efficiency, and transparency.

The Government may also need to prioritize public spending on critical areas, such as housing, healthcare, education, welfare, and digitalization, which can help address pressing societal needs, enhance the quality of life for citizens, and promote harmony and community wellbeing, as well as contributing to long-term economic development through upskilling the workforce, and driving innovation, efficiency, and competitiveness in the digital economy. Prioritizing spending in these key areas not only benefits the community directly but also lays a strong foundation for long-term sustainable growth and prosperity in HK. Encouragement could also be given to the private sector to help fund such social benefits, e.g., via charitable donations.

As regards capital works, there is also scope for phasing projects to spread capital expenditure over a longer period.

In view of the current fiscal situation, we see the establishment of the Committee on the Financing of Major Development Projects to review how to adopt an orderly and phased approach in developing the Northern Metropolis as a positive measure. Issuing bonds to finance major infrastructure projects is a reasonable approach. This is common way of funding long-term investment projects and the Government's current debt to GDP ratio, of 6.1%, in 2023 is way below that most developed jurisdictions, including Australia (51.9%), the UK (104.1%), Canada (106.4%) the US (123.3%), Singapore (167.9%) and Japan (255.2%)[50]. Clearly, there is considerable scope for further debt issuance without seeking to emulate these other examples. Of course, bonds need to be repaid and interest paid on them, and the demand for different types of bonds may fluctuate depending on the interest rate environment and a range of other factors. We note, for example, that the retail portion of an infrastructure bond launch in November 2024 was undersubscribed, although there was considerable institutional interest[51]. So, while bonds are a valuable tool for funding major capital works, they should not be relied upon to provide a complete solution.

The Government should also explore opportunities for public-private partnerships ("PPPs") by leveraging the successful experiences of other jurisdictions, such as Korea, and Japan and HK's own extensive experience of PPPs, including build-operate-transfer projects, such as the Eastern and Western cross-harbour tunnels. Since the introduction of e-tolls at the cross-harbour and other government tunnels, the resulting ease and efficiency of collection and the minimization of traffic congestion, particularly with the TVTs, have increased opportunities for more toll-based infrastructure as a potential revenue stream. Similar arrangements could be applied to bridges and faster roads. This could make PPP models more attractive to the private sector, but, equally, could just help the Government to recover the cost of capital works. As there are some arguments suggesting that PPP models may be more expensive and less efficient than public financing, careful consideration and in-depth analyses should be conducted to ensure the appropriateness and effectiveness of any proposed PPP financing.

[50] RB01_2024_20240409_en (1).pdf
[51] https://www.info.gov.hk/gia/general/202412/18/P2024121800216.htm?fontSize=1

Proposals

- ***Assess government spending regularly to identify areas where costs can be reduced, including streamlining operations, eliminating inefficiencies and, where feasible, increasing automation.***
- ***Prioritize public spending for impact: Focus spending on essential public services such as housing, healthcare, education, welfare and digitalization i.e., areas that provide the greatest benefit to the community and measures to stimulate economic growth.***
- ***Consider opportunities for public-private partnerships in funding major infrastructure development and also the expansion of toll systems as means of recovering the cost of public funding.***

Continue to monitor the effectiveness of "M" Mark events scheme

To develop mega-event tourism economy, we support the Government in taking a proactive role in attracting different major events to HK with an emphasis on quality and quantity, boosting the retail and hotel industries. At the same time, it is important to monitor the effectiveness of the "M" Mark events scheme to evaluate its actual economic impact. With over 210 mega events planned for 2024[52], including cultural, arts and creative events, sports, conventions and exhibitions, finance, economy, and I&T-related events; as well as festivals, celebrations, galas and carnivals, careful evaluation is essential to assess their actual impact on local businesses and tourism. In this regard, we are pleased to note that the Culture, Sports and Tourism Bureau has reviewed the operation and funding mode of the Mega Arts and Cultural Events Fund. We understand that the Bureau will enhance the operation of the Fund in the various areas, with a view to better and more effectively promoting the development of arts and culture, as well as boosting tourism and the economy. Monitoring "M" Mark events allows the Government to gather data on visitor spending and satisfaction, which can inform future planning and improvements. Additionally, it helps ensure that public funds are used effectively, maximizing returns on investment, while fostering a vibrant event culture that benefits the entire community. Refining arrangements based on feedback both from HK residents and visitors, can help enhance the quality of future events and maintain HK's ability to attract global visitors.

Proposal

- ***Continue to monitor the effectiveness of "M" Mark events, evaluate their actual economic impact, and, if necessary, refine the arrangements for such events.***

[52] https://www.info.gov.hk/gia/general/202405/21/P2024052100373.htm

Theme IV: Building a sustainable future

Overview

The Government is committed to striving to achieve carbon neutrality by 2050. In October 2021, the Environment Bureau released *Hong Kong's Climate Action Plan 2050*[53] ("CAP"), setting out the vision of "Zero-Carbon Emissions-Liveable City-Sustainable Development", and outlining the strategies and targets for combating climate change and achieving carbon neutrality, together with certain quantitative targets. The Institute supports HK's efforts to achieve carbon neutrality by 2050 and we are committed to helping the HK business community here to understand and adopt international sustainability reporting standards. The Government, regulators, as well as relevant industry organizations, should continue to promote sustainable development to the public and businesses, and drive and enforce the related regulations to enhance corporate sustainability performance and disclosure.

The Government launched a roadmap on sustainability disclosure in HK[54] ("Roadmap") on 10 December 2024. The Roadmap sets out HK's approach to requiring publicly accountable entities ("PAEs") to adopt the IFRS Sustainability Disclosure Standards, namely the IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and IFRS S2 *Climate-related Disclosures* (collectively, the "ISSB Standards"), providing a well-defined pathway for large PAEs to fully adopt the ISSB Standards no later than 2028. The Roadmap also states that the Institute, as the sustainability reporting standard setter for HK, is developing the Hong Kong Sustainability Disclosure Standards ("HKFRS SDS") in full alignment with the ISSB Standards. Following a public consultation on exposure drafts, which indicated general support for the proposed approach, the Institute *published HKFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information* and *HKFRS S2 Climate-related Disclosures* on 12 December 2024.

With this commitment to the comprehensive adoption of ISSB Standards in HK, we believe HK has taken an important step in sustainability reporting and disclosure. The Institute will continue to collaborate closely with the Government and financial regulatory bodies and to provide capacity-building activities for members and other stakeholders. All this aims to facilitate the development of a comprehensive local sustainability disclosure ecosystem and to solidify HK's status as a green finance centre. Having identified environmental, social and governance ("ESG")-related knowledge as one of the key areas for upskilling members, the Institute has stepped up its efforts to provide relevant training to keep its members abreast of the latest developments in this area.

The Institute, meanwhile, has long been a leading advocate of high standards of corporate governance ("CG") and sustainability, through our Best Corporate Governance and ESG Awards and related publications and research studies, including the recent reports, *Securing a Cyber Future - Current Landscape of IT & Cybersecurity Governance in Hong Kong*[55] (November 2024) and *ESG Assurance in Hong Kong 2023: An evolving landscape* (November 2023)[56] .

[53] https://www.eeb.gov.hk/sites/default/files/pdf/cap_2050_en.pdf
[54] https://www.fstb.gov.hk/fsb/en/publication/report/docs/FSTB_Roadmap2024_eBooklet_EN.pdf
[55] https://www.hkicpa.org.hk/-/media/Document/APD/BCGESGA/Cybersecurity-Report---Final.pdf
[56] https://www.hkicpa.org.hk/-/media/HKICPA-Website/New-HKICPA/Thought-Leadership/Reports/ESG-Assurance-Report-2023.pdf?la=en&hash=9DB41932B1990A8C86D17A5AB3DE9FB5

Meanwhile, we also propose various measures to help achieve long-term and interim decarbonization targets through green incentives and support.

Proposals

(1) <u>General policies to promote sustainability in Hong Kong</u>

According to scientists at the US National Aeronautics and Space Administration ("NASA")'s Goddard Institute for Space Studies, August 2024 set a new monthly temperature record, capping Earth's hottest summer since global records began in 1880 [57] and the World Meteorological Organization confirmed that 2024 was the warmest year on record[58]. Global sea levels have already risen by over 10cm between 1993 and 2024, according to NASA, which says sea levels have been rising at unprecedented rates[59]. Various extreme weather events have continued to batter different parts of the world, including heatwaves and severe droughts, which contribute to intense wildfires, blizzards, extreme rainfall-triggered flooding, tornadoes, and tropical cyclones.

Like other coastal cities, HK is prone to the impacts of climate change. The mean sea level in Victoria Harbour went up at a rate of 31mm per decade from 1954 to 2020 on average. Over the past century or so, the number of very hot days in HK has increased by more than seven times, and the number of hot nights has increased by more than 38 times. October 2024 in HK was the hottest October on record. The monthly mean maximum temperature of 30.3 degrees, monthly mean temperature of 27.3 degrees, and monthly mean minimum temperature of 25.4 degrees were 2.2 degrees, 1.6 degrees and 1.5 degrees, respectively, above their corresponding normal. We are also facing more severe tropical cyclone threats caused by extreme weather. Everyone is affected and HK must continue to play its part in combating global warming[60]. As noted above, the CAP, issued in October 2021, outlines the strategies and targets for combating climate change and achieving carbon neutrality, together with certain quantitative targets. Under the CAP, the Government will pursue more vigorous interim decarbonization targets, to reduce HK's carbon emissions by 50%, compared with 2005 levels, before 2035.

The CAP focuses mainly on the continuation and improvement of existing policies. To strengthen these policies, the Government should formulate a science-based, long-term comprehensive climate policy, such as long-term carbon reduction strategies, which should include researching low-carbon power generation technology, exploring the possibility of using more renewable energy, and incentivizing businesses to explore renewable energy options (installation of solar panels, etc.), as well as looking into energy storage and other technologies.

Support for recycling in HK is also patchy. There is a need for a more coordinated set of policies in this area, which can help both to reduce waste and also change mindsets and influence lifestyle choices within the community. We appreciate the Government's efforts in promoting waste reduction and recycling, including the GREEN@COMMUNITY recycling facilities, I·PARK 1 & 2. We also welcome the announcement in the 2024 PA that a common legislative framework for the producer responsibility schemes applicable to different products will be established, facilitating the future inclusion of products such as plastic beverage containers and beverage cartons progressively, expanding HK's waste-to-resources capacity (PA, para. 215). With an increasing number of EVs on the roads, among other things, we should also develop policies on the recycling of EV batteries. Meanwhile, a bill is expected in

57 https://www.nasa.gov/earth/nasa-finds-summer-2024-hottest-to-date/
58 https://www.info.gov.hk/gia/general/202501/13/P2025011300472.htm
59 https://www.weforum.org/agenda/2024/09/rising-sea-levels-global-threat/
60 https://www.legco.gov.hk/yr2024/english/panels/ea/papers/ea20240325cb1-321-6-e.pdf

2025 to ensure the safe use of hydrogen fuel, and formulate the proposed approach for hydrogen standard certification suitable to HK, as mentioned in the 2024 PA (para. 86(iii)).

In the coming years, the Government is embarking on major infrastructure projects, such as the Northern Metropolis. Such projects need to take HK's carbon neutrality targets into account and they should make use of eco-friendly materials, processes and designs. The work itself should as far as possible avoid contributing adversely to climate change and the infrastructure should be future-ready and adapted to a hotter future. In the light of recent developments and incidents, the public will also look to government to do its utmost to ensure safe work conditions for construction workers, and close oversight of other aspects of the work, so as to avoid large cost overruns, while ensuring quality and the proper use of public funds.

While environmental factors, such as green buildings, have been the primary focus of ESG initiatives across various sectors, we also need to recognize the importance of addressing social and governance criteria for the successful implementation of a comprehensive ESG framework. While efforts to reduce carbon footprints in offices remain the main focus of ESG conversations, importance should also be placed on promoting wellness, inclusion, and equity. The shift in how and where people work during the pandemic underscored the need for increased flexibility in office design. Enhancing the social aspects of ESG can contribute to maintaining a content, productive and healthy workforce, as well as attracting and retaining talented individuals. By addressing all three pillars of ESG, businesses can demonstrate their commitment to sustainability, social responsibility, and ethical business practices. In doing so, they can attract and retain talent, as well as investors, who give increasing priority to ESG considerations. Given the significance of the social aspects, we recommend that the Government and regulators initiate research on this area of ESG performance and consider establishing guidelines and benchmarks for companies to adhere to. This would further encourage businesses to incorporate robust social initiatives into their ESG frameworks, fostering a more sustainable and responsible business environment.

In terms of facilitating the further development of sustainability reporting in HK, as noted above, the Institute has published HKFRS S1 and S2, which are fully aligned with the ISSB Standards. We are also committed to supporting local stakeholders in their sustainability reporting journey and ensuring that our members are up to speed with corporate sustainability disclosure and reporting standards, both from the preparers' and the assurers' perspectives.

Against the above background, we propose consideration of the following policies to promote more sustainable development in HK:

Proposals

- ***Revisit the blueprints and roadmaps previously published in relation to Hong Kong's commitment to achieving carbon neutrality by 2050, establish effective interim targets and ensure HK is not falling behind.***
- ***Establish policies to support renewable energy targets and technologies, including supporting businesses to adopt more sustainable practices (including incentivizing them to explore renewable energy options (installation of solar panels, etc.)), and ESG standards.***
- ***Further explore the development and use of alternative energy in HK, such as green hydrogen, and facilities and plants for testing.***
- ***Ensure major new infrastructure projects incorporate sustainability goals in terms of planning, processes, materials and designs, etc. and that construction meets the highest quality and safety standards.***
- ***Develop a more coordinated set of policies on recycling. Consider incentives for downstream recycling, waste-to-resources/ energy infrastructure (e.g., subsidies on land costs and facilities); and explore and encourage activities such as the use of recycled building materials and second-life applications for EV batteries.***

- ***Research into the "S" or social aspects of ESG and consider establishing benchmarks for integrating social considerations into business practices.***

(2) <u>Measures in specific areas</u>

(a) Electric vehicles and green public transport

Over the past few years, resources have been allocated in the budget to take forward the building of a green city and implement a range of measures on various fronts to combat climate change. In June 2021, the Government announced the *Clean Air Plan for Hong Kong 2035*, setting out the vision under the slogan "Healthy Living - Low-carbon Transformation - World Class". The Clean Air Plan covers six major areas of action, namely green transport, livable environment, comprehensive emissions reduction, clean energy, scientific management and regional collaboration. In the 2022-23 budget, the Government committed that it would continue to promote new energy transportation so as to further enhance air quality and, as mentioned in the 2024 PA (para. 85), it will earmark around HK$750 million under the New Energy Transport Fund to subsidize the taxi trade and franchised bus companies to purchase EVs, and launch the Subsidy Scheme for Trials of Hydrogen Fuel Cell Electric Heavy Vehicles.

Private cars

In 2021, the Government issued the *Hong Kong Roadmap on Popularisation of Electric Vehicles*[61], and introduced a series of measures and targets, such as stopping the registration of fuel-propelled private cars in 2035 or earlier; promoting trials for electric public transport and commercial vehicles, including buses, public light buses, taxis and goods vehicles, and striving to legislate a producer responsibility scheme for retired EV batteries in the next few years.

We are pleased to note that about 70% of newly registered private cars ("PCs") in the first half of 2024 were EVs ("e-PCs"). To continue to facilitate the popularization of EVs, the Institute would reiterate that the infrastructure for EVs needs to be further enhanced, including installing fast charging stations in convenient locations. As at June 2024, there were about 8,700 public chargers, including 5,234 medium chargers and 1,511 quick chargers, in the 18 districts of HK[62]. With the Government's commitment in the 2024 PA to increase the number of public and private parking spaces with charging infrastructure to about 200,000 by mid-2027, $300 million has been earmarked for a new scheme, providing subsidies to the private sector for installing quick-charging facilities. The target is to have 3,000 quick chargers installed by 2030.

In order to meet the demand, the FS announced additional funding of HK$1.5 billion, on top of the original HK$2 billion for the EV-charging at Home Subsidy Scheme[63], which subsidizes private building owners to install charging stations in car parks of existing private residential buildings, to extend the scheme for four years to 2027-28. It is anticipated that the funding will be able to support installation of an EV charging-enabling infrastructure for around 140,000 parking spaces in 700 car parks in existing private residential buildings. However, we note that the scheme has already been closed since December 2023 as the applications received had reached the HK$3.5 billion funding ceiling. While we support the extension of the scheme, there is feedback that the application process can take as long as 2.5 years. Therefore, we suggest that the procedure be reviewed and that the approval process be expedited and streamlined. The Government may also consider other options to alleviate taxpayers' upfront

[61] https://www.evhomecharging.gov.hk/downloads/ev_booklet_en.pdf
[62]https://www.epd.gov.hk/epd/english/environmentinhk/air/promotion_ev/promotion_ev.html#:~:text=V.-,Locations%20of%20EV%20Chargers%20for%20Public%20Access,-As%20at%20the
[63] https://www.evhomecharging.gov.hk/en/

costs associated with the installation, such as providing a tax deduction for installation costs for EV home chargers.

We note that, given the rapid take up of e-PCs in Hong Kong in recent years, there have been some discussions on discontinuing the first registration tax ("FRT") concessions for them. Although the Government announced in the 2024-25 budget that the FRT concession arrangement for EVs will be extended for two years up to 31 March 2026, the FRT concession cap has been adjusted from HK$97,500 to HK$58,500. For PC owners who arrange to scrap and de-register their own eligible old PC with an internal combustion engine and then first register a new e-PC under the "One-for-One Replacement" Scheme, the FRT concession cap has been adjusted from HK$287,500 to HK$172,500. We recommend that these concessions remain in place, even if the caps are adjusted. It would send the wrong signal now to discontinue the concessions when all purchasers of new PCs should be encouraged to switch to e-PCs. The success of the concession is self-evident and, as noted above, the Government is planning to end the registration of fuel-propelled PCs by 2035, so, in the intervening time, purchasers of PCs should continue to be incentivized to make the transition earlier.

Commercial vehicles and public transport

In terms of commercial vehicles, while the Government targets to introduce about 700 electric buses and 3,000 electric taxis by end-2027, other new energy vehicles should also be explored with a view to achieving zero emissions by 2050. According to a survey conducted by the Hong Kong Productivity Council, with the assistance of the City University of Hong Kong, 55% commercial vehicle operators are willing to switch to hydrogen-fuelled vehicles if the operating costs are no more than 20% higher than the existing ones[64].

The Government will further promote the development and use of new energy in sea, land and air transport, so as to spearhead green transformation of the relevant trades. In addition to the New Energy Transport Fund as mentioned above, a bill for regulating hydrogen used or intended to be used as fuel will be introduced into the LegCo in 2025. We fully support the policy to encourage and support public transport operators to explore, test, and adopt and apply green innovative transport technologies, e.g., hydrogen fuel cell EVs, more widely.

We are pleased to note that HK's first hydrogen buses commenced service in October 2023 alongside the city's first hydrogen refuelling station, the core equipment of which has been completed and accepted by Citybus. Citybus plans to roll out an entire fleet of hydrogen buses by 2045[65]. In addition to the company's first hydrogen refuelling station on Hong Kong Island, which will provide hydrogen refuelling services for its production model hydrogen double deck buses, the Government also aims to establish hydrogen filling stations across Hong Kong Island, Kowloon, and the New Territories by 2027. In the meantime, HK has received its first hydrogen-powered light rail train and the MTR Corporation Limited plans to conduct a test run of a hydrogen-fuelled light rail vehicle to explore the feasibility of applying such technology here. These advancements signify significant progress in terms of exploring hydrogen-powered transportation.

We note the publication of the Strategy of Hydrogen Development in Hong Kong[66] in June 2024 and the Government's plan to submit legislative proposals to LegCo to provide a legal framework for regulating the manufacture, storage, transport, supply and use of hydrogen used, or intended to be used, as fuel, in the first half of 2025. To allow the industry to participate more actively in testing both battery-electric and hydrogen vehicles in parallel on HK's roads, we look forward to the announcement of hydrogen policies, including a roadmap and long-

[64] https://www.hkpc.org/en/about-us/media-centre/press-releases/2023/hk-hydrogen-economy-report-survey-result
[65] https://www.thestandard.com.hk/breaking-news/section/4/218399/Hydrogen-powered-Citybus-completes-first-tunnel-journey,-all-hydrogen-fleet-by-2045
[66] https://cnsd.gov.hk/strategy-of-hydrogen-development-in-hong-kong_booklet_en.pdf

term goals, establishing a clear and consistent regulatory framework, and providing economic incentives for clean hydrogen gas producers, hydrogen refuelling station operators, and certification organizations, in addition to policy support for infrastructure development. We also urge the Government to work closely with the industry in expediting the legislative process.

Although not all internal combustion engine vehicles can be replaced with EVs or a new energy equivalent at this stage, efforts should continue to be made to have older polluting vehicles removed from HK's roads.

E-motorcycles

In view of the increasing popularity of using electric mobility devices ("EMDs"), e.g. electric scooters, in recent years, the Government intends to update the law with a view to providing a proper regulatory framework for EMDs and embracing new technologies and innovations for personal mobility. We understand that the Transport Department is studying the regulatory arrangement for the use of EMDs in HK and associated certification arrangement to ensure their compliance with relevant technical and safety standards. It is suggested that only certified (labelled) EMDs be allowed on designated cycling tracks in the future. Meanwhile, we suggest that the Government review the speed limit and put forward practicable ways for law enforcement in order to strike a balance between promoting technological advancements and ensuring public safety on the roads.

Further, we propose that the Government encourage the establishment of battery swapping stations for e-motorcycles, while also providing financial support and fostering collaboration among stakeholders. This initiative will promote the wider adoption of EMDs and help reduce reliance on fossil fuels for short road trips within the city.

Support Battery-as-a-Service for EVs and battery recycling

The Government should support the development and adoption of battery-as-a-service ("BaaS") for EVs to enhance convenience and affordability for consumers. With the battery swapping technology, BaaS is a service model enabling people to buy an EV without buying its battery pack, whereby customers can sign up for energy plans paying monthly rental fees for battery use, being able to choose battery packs of different capacities. Battery-swapping stations allow users to quickly exchange depleted batteries for fully charged ones, significantly reducing downtime. This model aims to address some of the common challenges associated with EV adoption, including high upfront costs, concerns about battery degradation, and the need for convenient charging infrastructure. A range of companies have been being active in this market, including automakers, battery manufacturers, energy service providers, startups, and tech giants. Tesla, for instance, has introduced BaaS options for its electric vehicles. Various jurisdictions, including the Mainland[67], Japan[68], and the US[69] have already been exploring and/or adopting BaaS model. This approach can reduce the initial cost of EVs, making them more accessible to a wider market, and supports the local economy by fostering innovation and creating new business opportunities in the EV sector. By adopting a BaaS framework, HK can encourage a wider EV adoption, and promote a sustainable transportation ecosystem while aligning itself with global trends in green mobility.

At the same time, we propose the development of a more coordinated set of policies on recycling to enhance waste management practices and promote sustainability. Among other things, the Government should actively support and incentivize the development of second-

[67] https://transition-china.org/wp-content/uploads/2022/08/battery-swapping.pdf
[68] https://www.emergingtechbrew.com/stories/2024/08/23/ev-battery-swapping-startup-ample-tests-out-its-tech-on-japan-s-roadways
[69] https://www.shoosmiths.com/insights/articles/battery-as-a-service-an-underexplored-opportunity-the-resurgence-of-baas#:~:text=easily%20replicated%20elsewhere.-,United%20States,-In%20the%20United

life applications for EV batteries. In addition to extending the producer responsibility schemes[70] to EV batteries, this can also be achieved by encouraging the reuse of these batteries in various energy storage systems, thereby extending their lifespan and reducing waste. Additionally, measures such as providing subsidies and support for R&D in the field of EV battery recycling should be considered. With such initiatives, HK can enhance its sustainable battery practices, minimize the environmental impact, and foster a circular economy in the EV sector.

We propose, therefore, the specific measures below in relation to green transport.

Proposals

- ***Extend the EV-charging at Home Subsidy Scheme, and streamline and expedite the approval process. Consider other options as well, such as providing a tax deduction for installation costs for EV home chargers.***
- ***Continue to offer first registration tax concessions for private car EVs.***
- ***Continue to encourage and support public transport operators to explore, test and adopt more widely, the application of green innovative transport technologies, e.g., hydrogen fuel cell EVs.***
- ***Where there are currently no EV or new energy alternatives, adopt, as a minimum, the Euro VI emission standard for all commercial vehicles and consider further incentives for replacement of Euro IV and V vehicles.***
- ***Legalize and support the use of electric mobility devices, including electric scooters.***
- ***Support the setting up of battery swapping stations for e-motorcycles.***
- ***Support the development and adoption of Battery-as-a-Service for EVs in Hong Kong.***
- ***Develop policies on the recycling and reuse of EV batteries.***

(b) Green buildings

In recent years, many countries have introduced green building certification systems to provide indicators for building performance and encourage the adoption of low-carbon construction methods for structures that are newly built, undergoing renovation, or already occupied. Common green building certification systems in HK include the Leadership in Energy and Environmental Design (LEED[71]) by the US Green Building Council and BEAM Plus[72] New Buildings by the Hong Kong Green Building Council. Buildings constitute the largest source of energy usage in HK. The CAP notes: "Buildings account for about 90% of Hong Kong's total electricity consumption, and over 60% of our carbon emissions are attributable to generating electricity for our buildings". However, new buildings that are not very energy efficient are still being constructed, while green building codes, such as BEAM Plus, in HK, remain voluntary. In recent years, we are pleased to note the Government's application of renewable energy in government buildings and facilities, as well as support for public and private organizations to use renewable energy, to help HK realize its carbon neutrality target (2024 PA, para. 85). We agree that the measures should be extended to the private sector and the Government should explore incentives to drive the development of more private green buildings. Developers should also be encouraged and incentivized the use of green building materials, including green cement, in construction.

[70] https://www.epd.gov.hk/epd/english/environmentinhk/waste/pro_responsibility/index.html
[71] https://www.usgbc.org/leed/why-leed
[72] https://www.hkgbc.org.hk/eng/beam-plus/beam-plus-new-buildings/index.jsp

In addition to the above, the Government should actively encourage the adoption of the WELL label[73], which emphasizes occupant health and well-being in the built environment, by educating stakeholders about the benefits of WELL-certified spaces. Allocating resources to research on the health effects of building environments will underscore the significance of these initiatives, leading to the cultivation of a healthier community and the improvement of overall quality of life.

Incentivize buildings that adopt environmental best practices

In addition to considering mandating key elements of green building codes in new buildings and incentivizing/ subsidizing retrofitting and/or developing best practice standards for energy-efficient buildings in HK, providing enhanced commercial and industrial building allowances for new commercial and industrial complexes that adopt approved, environmentally-sustainable, designs could be another effective means to encourage developers to build greener, more energy-efficient buildings.

Incentivize owners of old residential buildings to renovate their buildings sustainably

There are many older residential buildings in HK in need of renovation and repair. However, owners may be put off by the potential costs involved, despite any legal obligations that they may have to ensure the safety of their property. Therefore, we suggest that they be encouraged to undertake environmentally-friendly renovation works. One option would be to consider leveraging on the Common Area Repair Works Subsidy offered by Building Rehabilitation Platform (an all-in-one information platform managed by Hong Kong Building Rehabilitation Facilitation Services Limited, a subsidiary company of the Urban Renewal Authority), which has a Green Item Subsidy[74].

The Government should actively promote the Energy-efficient Equipment Subsidy Programme and Electrical Equipment Upgrade Scheme offered by HK Electric and CLP respectively, so that more companies can apply for subsidies to upgrade their premises with energy-efficient lighting and air-conditioning systems.

Proposals

- ***Adopt best practice standards for energy-efficient buildings in Hong Kong and mandate some requirements.***
- ***Consider Introducing enhanced industrial and commercial building allowances for buildings that follow best practice standards (e.g., an initial allowance of 25% and an annual allowance of 5% for industrial buildings and, say, an annual allowance of 6.5% for commercial buildings).***
- ***Encourage/ incentivize the use of green building materials, including green cement, in construction.***
- ***Encourage the adoption of the WELL label by educating stakeholders about the benefits.***
- ***Incentivize owners of old residential buildings to renovate their buildings sustainably.***
- ***Advocate the energy-efficient equipment subsidy schemes provided by HK Electric and CLP to encourage businesses to upgrade their premises with energy-efficient lighting and air-conditioning systems.***

[73] https://www.wellcertified.com/
[74] https://www.brplatform.org.hk/en/sustainability-in-building-rehabilitation/green-item-subsidy

(c) Energy efficiency

To make it easier for the public to choose energy efficient products, the Electrical and Mechanical Services Department operates a voluntary Energy Efficiency Labelling Scheme for appliances and equipment used both at home and office, as well as for vehicles. The scheme aims to save energy by informing potential customers of the product's level of energy consumption and efficiency rating, so that buyers can take these factors into consideration when making their purchasing decisions. We suggest that the Government should make use of the scheme and promote a "replace old items with new ones" initiative by providing subsidies to consumers who purchase specified energy-efficient appliances, such as air-conditioners, refrigerators, washing machines, and televisions, etc., with a Grade 1 energy label. This approach not only encourages residents to upgrade to more efficient models, but also contributes to significant energy savings. Additionally, incorporating a "trade-in" programme could further incentivize consumers to recycle their old equipment responsibly. By allowing customers to trade in their outdated appliances for discounts on new purchases, the Government can ensure that these items are disposed of properly or refurbished, reducing waste and promoting a circular economy.

By making energy-efficient appliances more affordable through subsidies and trade-in options, the Government can foster a culture of sustainability while helping improve the overall standard of living for residents. Such a scheme could also encourage manufacturers to produce more energy-efficient appliances. Consequently, this initiative could lead to both economic and environmental benefits for HK.

Proposal

- ***Promote "replace old items with new ones" to the public by providing subsidies to consumers who trade in old appliances for specified energy-efficient appliances, e.g., air-conditioners, refrigerators, washing machines, televisions, etc., with Grade 1 energy label, and provide for the safe disposal of the old, traded-in items.***

(d) Green finance

The 14thF FYP supports the HK's development as a centre of green finance in the GBA. We welcome the initiative to develop the city as a regional green and sustainable finance hub, including encouraging institutions to conduct relevant investment, financing and certification activities and attracting top-notch institutions and talents to HK to provide the relevant services. By leveraging its advantages as an international financial centre, HK can facilitate matching between international capital and quality green projects, as well as helping the drive towards carbon neutrality by 2050 and promoting green transformation of the economy.

With the Government's strong support, HK has become a leading sustainable finance hub in Asia. Our green and sustainable debt market has been expanding rapidly over the past few years, and an international carbon market (Core Climate) has been launched by the HKEX, becoming the only carbon market to offer HK dollar and renminbi settlement for trading of international voluntary carbon credits.

The 2024 PA (para. 46) mentioned that the Government will roll out the "Sustainable Finance Action Agenda", launch a roadmap on the full adoption of the ISSB Standards and be committed to strengthening the development of green and sustainable finance. As noted above, we were pleased to see the launch of the Roadmap in December 2024. These initiatives will help foster the implementation of the sustainability disclosure regime reflected in the Vision

Statement on Turning Obligations into Opportunities in Developing the Sustainability Disclosure Ecosystem in Hong Kong[75], released in March 2024, to bring certainty to the capital market and foster capital inflows into the local market. The Roadmap sets out HK's approach to requiring PAEs, including large listed issuers and non-listed financial institutions of significant weight, to fully adopt the ISSB Standards no later than 2028. We suggest that consideration be given to incentivizing PAEs to adopt the ISSB Standards ahead of the 2028 deadline.

In order to expand the talent pool and enhance capacity building for practitioners on green and sustainable finance ("GSF"), we would suggest enhancing and extending the Pilot Green and Sustainable Finance Capacity Building Support Scheme[76], which aims to support talent development in GSF by providing subsidies to market practitioners and prospective practitioners to take up relevant training and acquire relevant professional qualifications, up until December 2027.

Develop a more extensive framework for the adoption of ESG assurance

It is clear from the measures referred to above, that various active steps are being taken to develop HK into a regional and international green finance hub. In order to enhance transparency and accountability in corporate practices, we would also support the development of a more extensive framework for the adoption of ESG assurance. This initiative would not only bolster investor confidence but also promote responsible business practices that align with global sustainability goals.

Deduction of the costs incurred on purchasing renewable energy credits ("RECs")

Taxpayers may purchase RECs or carbon credits on a voluntary basis as a means to lower their carbon footprint, or meet their greenhouse gas emission goals. For example, a business group can purchase RECs from the market in a year to match its electricity consumption relating to business operations/ activities in that year with an equivalent amount of energy produced in renewable energy projects. The purchase of RECs will generate a renewable energy certificate, indicating the estimated amount of carbon emissions that has been avoided in that year. To support more taxpayers to participate in ESG initiatives, as interim measure to help companies meet their carbon reduction targets, we suggest that the Government should consider allowing a deduction of the costs incurred on purchasing appropriately certified RECs or carbon credits, by companies chargeable to HK profits tax, possibly up to a certain limit, to recognize that, increasingly, corporate responsibility is, seen as an essential part of the normal course of business. Such deductions should also be extended to the costs shared among group companies in relation to the purchase of RECs or carbon credits. This concession should be reviewed after, say, five years. Ultimately, companies need to be encouraged to reduce their own emissions directly.

<u>Proposals</u>

- ***Following the publication of the Roadmap on Sustainability Disclosure in Hong Kong, the Government should consider encouraging large publicly accountable entities to voluntarily adopt ISSB Standards, or HKFRS Sustainability Disclosure Standards, which are fully aligned with ISSB Standards, before the mandatory 2028 deadline, by offering enhanced tax deductions on qualifying expenditures, including outsourcing costs and staff costs for sustainable finance professionals, etc.***

[75] https://gia.info.gov.hk/general/202403/25/P2024032500391_452899_1_1711358339971.pdf
[76] https://www.greentalent.org.hk/

- ***ESG assurance: Develop a more extensive framework for the adoption of ESG assurance.***
- ***Extend the Pilot Green and Sustainable Finance Capacity Building Support Scheme for two years.***
- ***As an interim measure, allow a deduction of the costs incurred on purchasing appropriately certified renewable energy and carbon credits, up to an appropriate ceiling.***

Appendix 1: Proposed changes for salaries tax allowances and deductions[77]

Allowances and deductions	Existing (HK$)	Proposed (HK$)
Allowances[78]:		
- Basic	132,000	133,980
- Married person	264,000	267,960
- Child (annual, each dependant, the 1st to 9th child)	130,000	131,950
- Child (initial, each dependant, the 1st to 9th child)	130,000	131,950
- Dependent brother or sister (each dependant)	37,500	38,062
- Dependent parent/ grandparent (each dependant)		
- aged 60 or above or is eligible to claim an allowance under the Government's disability allowance scheme	50,000	50,750
- aged 55 or above but below 60	25,000	25,375
- Additional dependent parent/ grandparent (each dependant)		
- aged 60 or above or is eligible to claim an allowance under the Government's disability allowance scheme	50,000	50,750
- aged 55 or above but below 60	25,000	25,375
- Single parent	132,000	133,980
- Personal disability	75,000	76,125
- Disabled dependant (each dependant)	75,000	76,125
Deductions, maximum limit:		
- Self-education expenses	100,000 limited to claims by taxpayer	100,000 limited to claims by taxpayer or dependants
- Voluntary Health Insurance Scheme ("VHIS") premiums	8,000	12,000
- Rental payment for taxpayer's primary residence	100,000 (basic)	100,000 (basic)
- Home loan interest	100,000 (basic)	100,000 (basic)

[77] The forecast rates of underlying and headline consumer price inflation for 2024 are revised down to 1.3% and 1.9% respectively.

https://www.hkeconomy.gov.hk/en/situation/development/index.htm
https://www.hkeconomy.gov.hk/en/pdf/24q2_pr.pdf

[78] For illustration purposes, the proposed allowances are increased on the assumption that the benchmark is set at current levels and the inflation rate is 1.5%.

Appendix 2: Proposed changes in salaries tax allowances and deductions - impact on a typical individual

Example: Single person

This example illustrates the impact of[79]:

- an increase of basic allowance to HK$133,980
- an increase of the annual limit on the deduction of qualifying premiums paid under VHIS policy to HK$12,000

	Existing (HK$)		Proposed (HK$)		Savings (HK$)	Savings (%)
Income		300,000		300,000		
Allowances/ deductions:						
Basic allowance	132,000		133,980			
Mandatory MPF contribution	18,000		18,000			
Qualifying premiums paid under VHIS	8,000		12,000			
Home loan interest/ Rental payments	100,000		100,000			
Total allowances/ deductions		258,000		263,980		
Net chargeable income		42,000		36,020		
Tax payable		840		720	120	14%

[79] Assumptions are as for Appendix 1.

Appendix 3: Proposed changes in salaries tax allowances and deductions - impact on a typical family

Example: Married person with spouse separately assessed, one children who is not newborn, and living with two dependent parents over 60 years of age throughout the whole year

This example illustrates the impact of[80]:

- an increase of basic allowance to HK$133,980
- an increase in child allowance to HK$131,950
- an increase in dependent parent allowance and additional allowance to HK$50,750
- an increase of the annual limit on the deduction of qualifying premiums paid under VHIS policy to HK$12,000

	Existing (HK$)			Proposed (HK$)			Savings (HK$)	Savings (%)
Income			750,000			750,000		
Allowances/ deductions:								
Basic allowance		132,000			133,980			
Child allowance	1 children 130,000 each	130,000		1 children 131,950 each	131,950			
Dependent parent allowance and additional allowance	2 parents 100,000 each	200,000		2 parents 101,500 each	203,000			
Mandatory MPF contribution		18,000			18,000			
Qualifying premiums paid under VHIS	1 taxpayer and 1 children 8,000 each	16,000		1 taxpayer and 1 children 12,000 each	24,000			
Home loan interest/ Rental payment		100,000			100,000			
Total allowances/ deductions			596,000			610,930		
Net chargeable income			154,000			139,070		
Tax payable			9,560			7,907	1,653	17%

[80] Assumptions are as for Appendix 1.